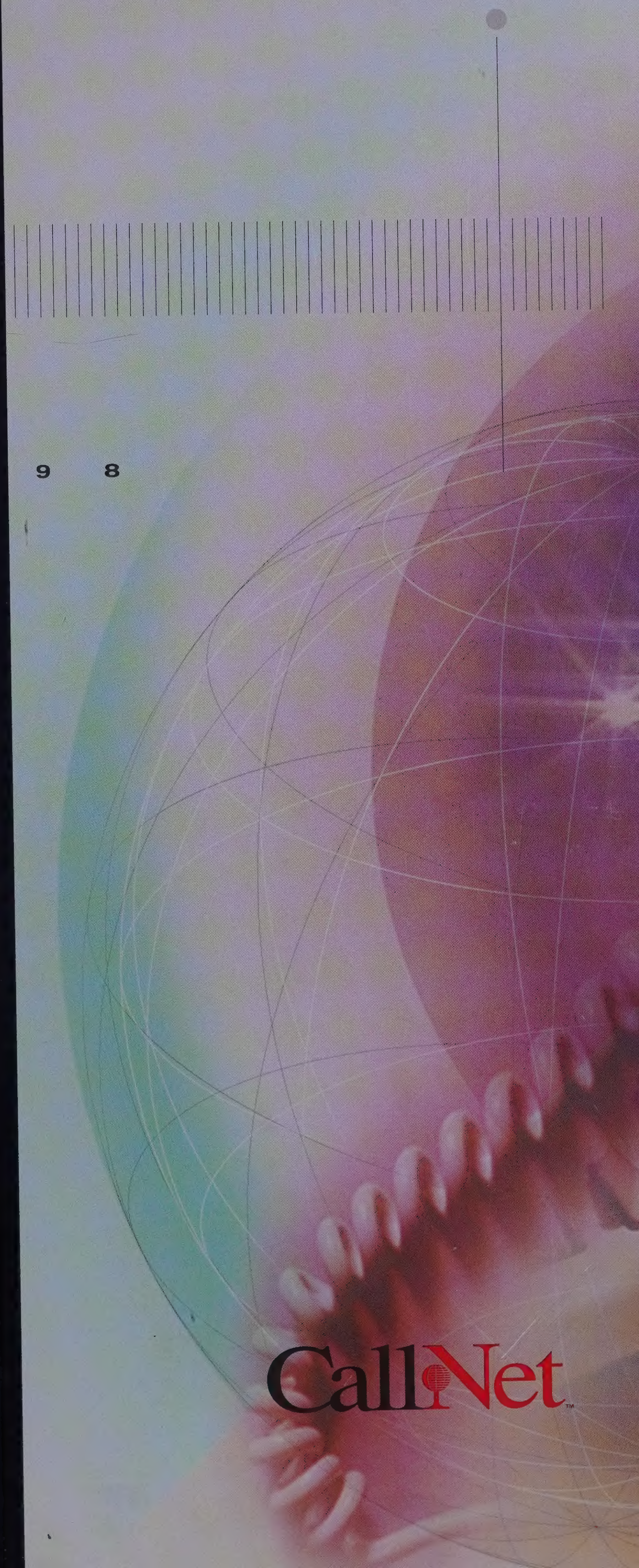
CALL-NET ENTERPRISES INC.

1998

ANNUAL REPORT



CallNet™

MAJOR ADVANCES IN 1998

- Through internal growth and acquisition, firmly established as the leading national competitor to Canada's former monopoly telephone companies.
- Grew to position of Canada's second largest Internet service provider.
- More than doubled revenue from high-speed business data services.
- Acquired trans-Atlantic cable facilities and installed a gateway switch in England to launch an international network.
- Built infrastructure for launch of local service in the first quarter of 1999.

($ millions, except as noted)	**1998**	1997	1996
Revenue	**1,227.6**	920.9	712.6
Gross profit	**439.9**	415.2	267.9
Gross margin	**35.8%**	45.1%	37.6%
EBITDA	**(22.0)**	90.5	43.1
Net income/(loss)	**(236.7)**	16.3	(7.1)
Cash flow from operations	**(29.6)**	99.4	51.6
Cash and short-term investments	**189.3**	558.4	170.1
Capital assets	**953.1**	242.6	169.7
Long-term debt	**1,332.7**	564.9	186.0
Shareholders' equity	**984.4**	290.6	253.0

PROFILE

Founded in 1986, Call-Net:

- provides local, long distance, business data, Internet access, and overseas services, primarily under the Sprint Canada brand name;
- serves large corporations, governments, small and medium businesses, carriers and consumers; and
- owns a high-capacity long distance fiber optic network across Canada and is completing a national long distance fiber optic network in the United States.

The Company's shares trade on the Toronto and Montreal stock exchanges and on The Nasdaq Stock Market.

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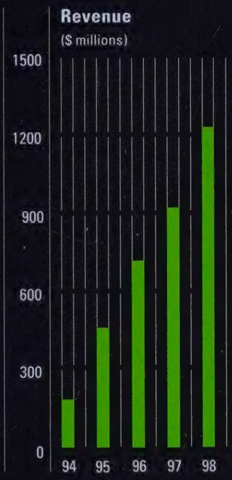
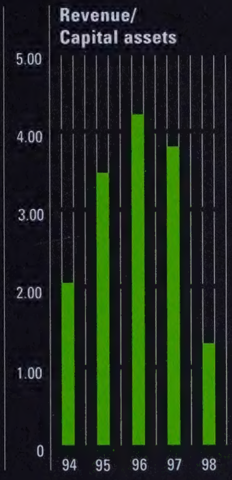
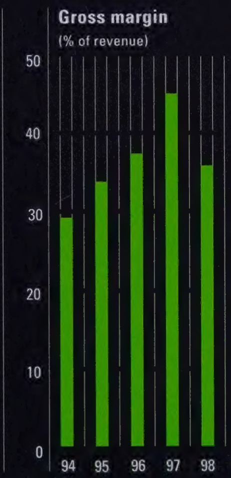
Revenue increased by 33% to $1.2 billion in 1998, driven by continued expansion of long distance and business data services, especially among large companies, and the introduction of Internet access.

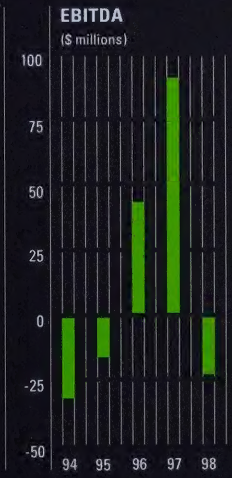




The ratio of revenue to capital assets changed from 3.80 in 1997 to 1.29 in 1998. The change reflects Call-Net's $1.8 billion purchase of *f*ONOROLA and the transformation of Call-Net into a North American facilities-based telecommunications company.

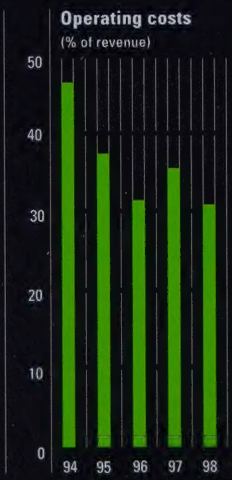
The competitive flat rate long distance market coupled with growth in our wholesale business squeezed gross margin to 36% of revenue from 45% in 1997. The lighting of our long distance fiber optic network and launch of overseas service will reduce transport costs and improve margin.

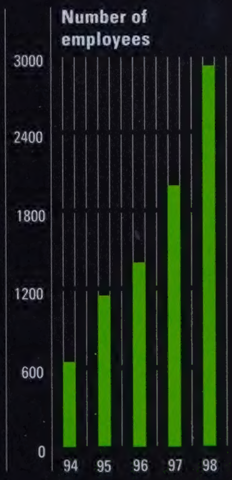




Negative EBITDA of $22 million reflected a $39 million investment in new services and an $82 million integration and restructuring charge related to the *f*ONOROLA acquisition. EBITDA from long distance and data services was $99 million.

As a percent of revenue, operating costs declined to 31% from 35%. In 1998, we invested in growing long distance, business data and Internet access services while planning our entry into local and overseas services.





Staff expanded from approximately 2,000 to 2,800 in 1998. Employment levels in Canada will continue to increase to keep pace with our growth as a truly integrated, full-service telecommunications company. We are also expanding our operating company in the United States.

WE ARE NOW EMBARKED ON A NEW FIVE-YEAR STRATEGY TO GROW CALL-NET INTO A MULTI-BILLION DOLLAR COMPANY.

In 1998 we completed a five-year planning cycle that grew Call-Net into a full-service facilities-based telecommunications company generating $1.2 billion in annual revenue.

The past In 1993 we set out to be a $1 billion company by 1998 with a 15 percent share of the Canadian long distance market by 2000. These were ambitious targets considering we ended 1992 with revenue of $83 million, or one percent of what Canadians then spent on long distance.

Our strategy involved the development of new products and services targeted at specific customer segments and rolled out sequentially in geographic markets. By following this strategy, we exceeded the $1 billion revenue target in 1998 and achieved the market share target two years ahead of schedule. Today, we serve all customer segments in all provinces and continue to expand our portfolio of telecom products and services.

The $1.8 billion purchase of *f*ONOROLA Inc. in mid-1998 solidified our position as Canada's largest national long distance and data company. It also gave us a fiber optic network across Canada and a national network in the United States.

The telecom environment The environment in which we compete is going through profound change. Competition is sweeping away artificial distinctions between long distance, local, domestic and international telecommunications, as well as among different modes of communication. Customers want to converse, send messages, transport huge amounts of data, share images and videos, transact business online and connect with each other in the easiest and fastest way possible. Old notions of segmented telecommunications are disappearing as we develop more sophisticated products and services that focus on integrated solutions.

The nature of competition has also changed as the barriers to foreign ownership of Canadian telecommunications appear to have been removed without any formal rule amendment. Foreign-owned and controlled firms have effectively circumvented what remains of the ownership limitations, increasing the pressure on us to focus on delivering solutions, functionality and value that matter to customers.

Our future We are now embarked on a new five-year strategy to grow Call-Net into a multi-billion dollar company.

In Canada, we will continue to expand in long distance as we take advantage of our coast-to-coast fiber optic network to reduce transmission costs. However, a growing portion of our revenue will come from business data, local, Internet, and mobile wireless services. Our phased entry into local services, starting in 1999, is a key element of our strategy to become a truly integrated full-service company.

Entry into markets outside Canada will leverage our core strengths in marketing, customer service, product development and network management. The United States is a major new opportunity for Call-Net. Currently, we generate about $100 million in annual wholesale revenue and we are completing an extensive national U.S. long distance fiber network, which has significant intrinsic value. The network and our core competencies in operating a large customer-focused telecom company are the foundation for a U.S. growth strategy. We are putting a management team in place to implement our successful formula of developing products for specific customer markets and offering those products in one geographic market at a time.

Another opportunity outside Canada is overseas services. As a domestic carrier, we originate approximately 30 percent of Canada's outbound overseas traffic, yet government policy required us to use Teleglobe's facilities for overseas connections until late 1998, when that monopoly ended. Now we can negotiate our own contracts with international carriers for inbound and outbound services to the benefit of both our customers and our shareholders. We will also handle a growing portion of overseas traffic through our own international network.

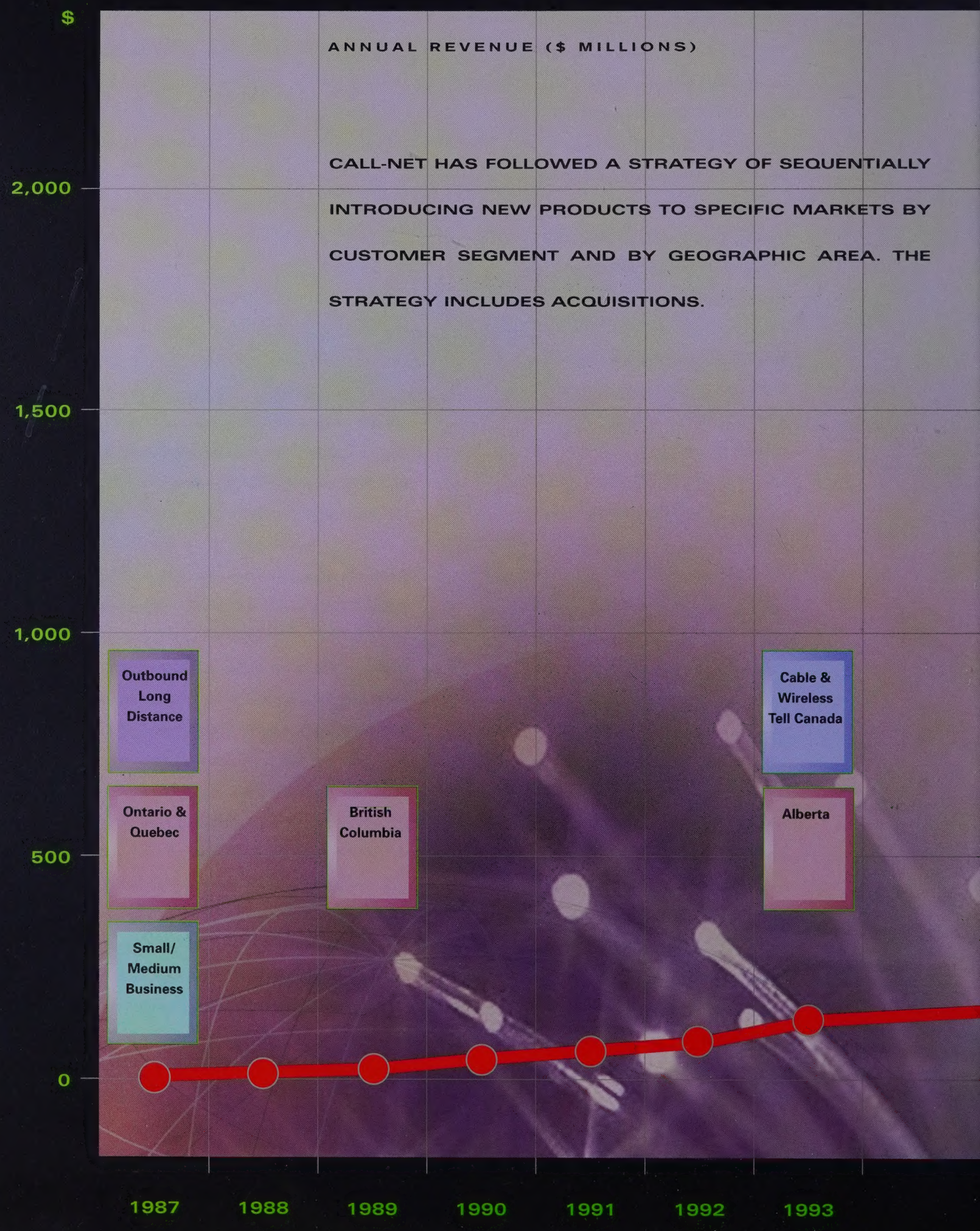
Shareholder value When we launched our first five-year plan, the value of Call-Net shares declined as we invested in new growth areas. A similar situation occurred in late 1998 as we entered the current planning period with heavy investments in new growth areas. We remain confident, however, of growing Call-Net into a profitable multi-billion dollar company that will enhance long-term shareholder value.

Acknowledgements Finally, I thank our investors, customers and employees for their commitment during the past year. With their continued support, Call-Net will emerge as a stronger and profitable company.

Juri Koor

Juri Koor, *Chairman*

CALL-NET HAS FOLLOWED A STRATEGY OF SEQUENTIALLY INTRODUCING NEW PRODUCTS TO SPECIFIC MARKETS BY CUSTOMER SEGMENT AND BY GEOGRAPHIC AREA. THE STRATEGY INCLUDES ACQUISITIONS.



fONOROLA
Local
Integrated Network Services (INSINC)
STN
Dial-up Internet
United States
Europe
Business Data
Carriers
Saskat-chewan
Toll Free Service
Manitoba
Government
Atlantic Canada
Large Business
Consumers
Product Offerings
Geographic Markets
Customer Markets
Acquisitions
1994
1995
1996
1997
1998
1999
2000

Call-Net has entered a new phase of growth based on exploiting the building blocks put in place in 1998 and prior years. These strengths are:

- Sprint Canada's solid position as the largest national long distance and business data company in Canada;
- Sprint Canada's rapid growth as a leading Internet service provider;
- development of non-Sprint branded products, such as wholesale services, overseas services and dial-around long distance;
- a low-cost long distance fiber optic network in Canada, put in service in April 1999;
- phased entry into local services, starting in 1999; and
- development of the national fiber optic network in the United States, scheduled for completion in the first quarter of 2000.

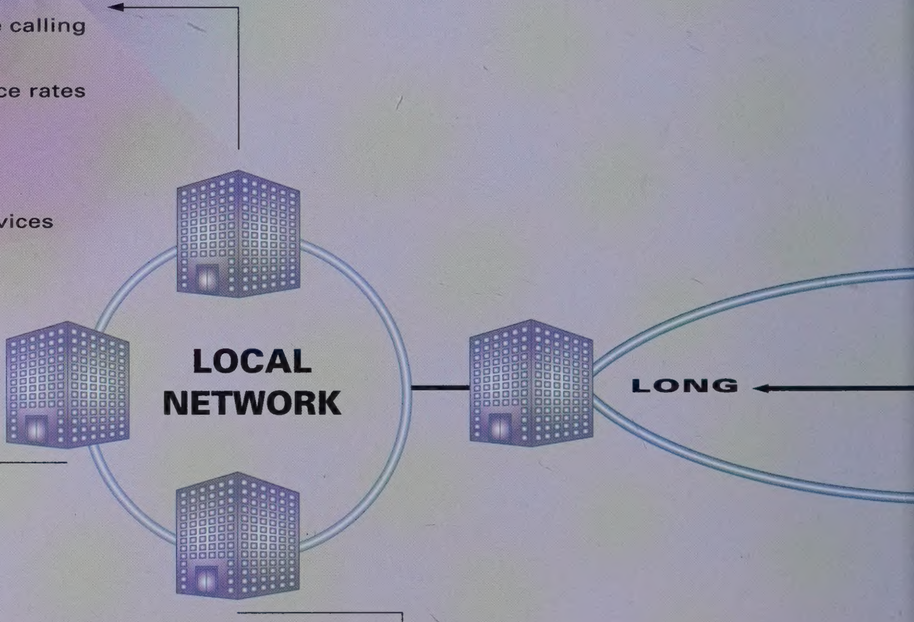
WE CONTINUE TO GROW!

1998 Revenue Growth

Business long distance	+48%
Business data	+116%
Residential long distance	+9%
Residential Internet	+1,617%
Total	+33%

CORPORATIONS & GOVERNMENT

- Long distance and toll free calling
- Foncard
- By-the-Minute long distance rates
- Teleconferencing
- Bill analysis software
- Business Internet services
- Network management services
- Frame relay
- High speed private line
- Router management
- ATM



RESIDENTIAL / CONSUMERS

- Long distance
- Local
- Foncard™
- By-the-Minute long distance rates
- Internet access

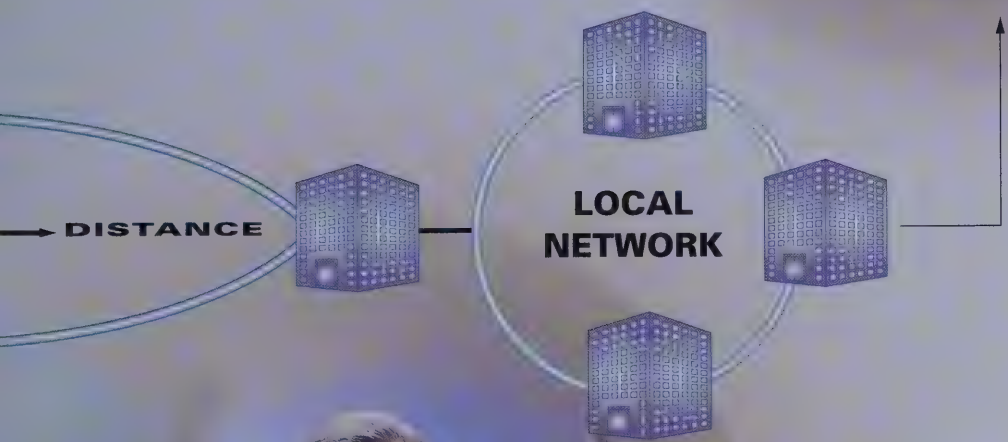
MEDIUM BUSINESS

- Long distance and toll free calling
- Foncard™
- By-the-Minute long distance rates
- Bill analysis software
- Business Internet services
- Network management services
- Frame relay
- High speed private line
- Teleconferencing
- Router management

CALL-NET PROVIDES A FULL SUITE OF SERVICES IN CANADA. LOCAL SERVICES ARE A NEW GROWTH AREA IN 1999. WE ARE ALSO DEVELOPING NEW SERVICES IN THE UNITED STATES AND OVERSEAS.

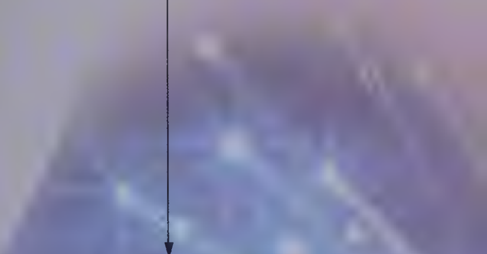
SMALL OFFICE / HOME OFFICE

- Long distance and toll free calling
- Foncard™
- By-the-Minute long distance rates
- Bill analysis software
- Internet access



CUSTOMER SERVICE

- Consolidated billing
- 7 x 24 operations
- Network management
- Billing inquiries
- Trouble resolution



CARRIERS / RESELLERS / ISPs

- Internet backbone network
- Router management
- Transit services
- Switched long distance
- Canadian overseas termination
- High speed private line

About 53 percent of our revenue comes from business customers and 47 percent from residential customers. Our business customers include Canada's largest banks, major stock exchanges, transportation companies, national retailers, international manufacturers, and federal and provincial government departments and agencies.

Long distance services We began offering outbound voice services to small business clients in Ontario and Quebec in 1987. In mid-1994, we added long distance services for Canadian households and in 1995 for large corporations, and other carriers. By 1996, we were operating in all Canadian provinces and in all customer segments.

While we ended 1998 with more than an 18 percent share of the Canadian switched long distance market, our growth is far from over in this market sector. We continue to develop and introduce new products for both business and residential customers.

Sprint Canada is the nation's most recognized telecom brand and has gained a

OUR BUSINESS CUSTOMERS INCLUDE CANADA'S LARGEST BANKS.


1999
2000
1919

reputation for quality, reliability and value. We were ranked number one by businesses in customer satisfaction for voice services in 1998.

We continue to experience strong growth among small and medium-sized businesses, where we have a 30 percent market share. Our penetration of the large corporate and government sector has accelerated as we expand our ability to offer more complex solutions, and we are building on our established relationships with carriers and offering services to new carriers.

Each year, we have introduced pricing and service plans, based on savings and simplicity, that have changed the economics of long distance calling, gained market share, and forced competitors to follow our lead.

The launch of North America's first nationwide flat-rate long distance plan in early 1998 was so successful that it caused network congestion and squeezed margins. Competitors were quick to copy our plan. We resolved the network congestion by capping calls at 800 minutes for $20 per month.

In 1998, we targeted for the first time the large segment of customers who seek long distance savings without switching their carrier. We tested in Ontario, outside the Sprint Canada brand, our BUCK-A-CALL™ dial-around product. The tests were so successful that this product will roll out nationally in 1999.

WE HAVE THE BUILDING BLOCKS IN PLACE TO SUPPORT A SOLID NEW CYCLE OF BROADER-BASED GROWTH.

Business data services We entered the business data market in 1994 and today offer services to businesses of all sizes. As a business data specialist, we provide end-to-end network management services on an international, national, regional and local

basis. Building on our reputation for network reliability and customer service, we more than doubled our revenue from data services to $125 million in 1998. Our focus is on the high-speed digital market, which is growing by more than 25 percent a year.

In 1998, we focused on developing new products and enhancing our data services platform with sophisticated frame relay and ATM (asynchronous transfer mode) technology. We provide Internet backbone access at 45 megabits per second and private line service at 600 megabits per second – speeds that lead the industry. We were the first company to receive national "Cisco Powered Network" certification for Internet services in Canada.

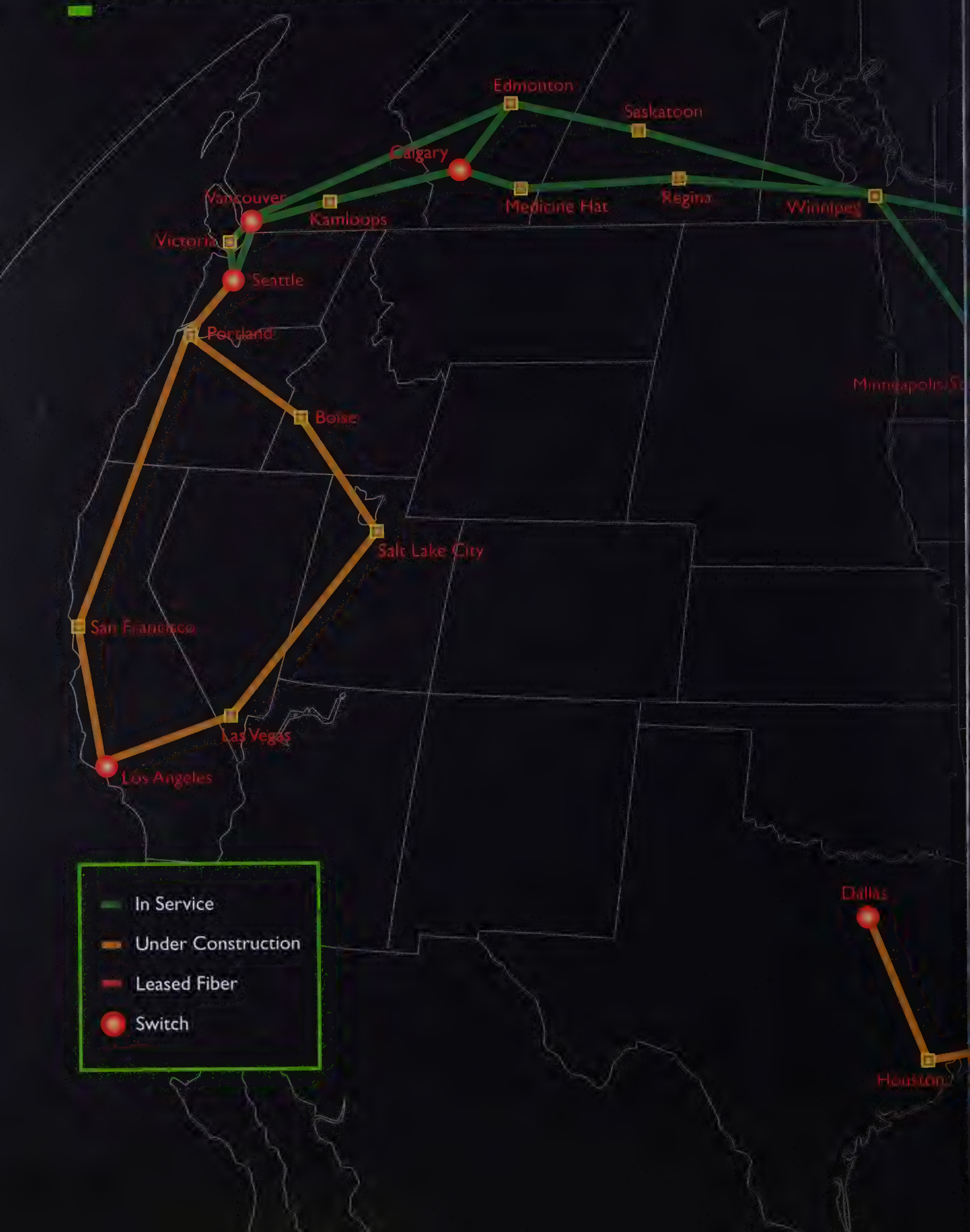
In 1999, we will further advance our leading position as a reliable provider of data services that resolve complex business challenges. We will, for example, offer ATM products that allow business customers to move voice, data and video information on a single network and control the quality of each transmission package independently. The launch of our national fiber optic network in April 1999 enables us to enhance reliability and expand our product offering.

WE WILL FURTHER ADVANCE OUR LEADING POSITION AS A RELIABLE PROVIDER OF DATA SERVICES THAT RESOLVE COMPLEX BUSINESS CHALLENGES.

Internet services We entered the Internet market in late 1997 by launching a dial-up product, THE MOST™ online, for consumers and small businesses. We are one of the few Internet service providers (ISP) to offer service on a national basis.

We ended 1998 with more than 140,000 customers, of whom approximately 65 percent were also our long distance customers. Further strong growth is anticipated following the January 1999 introduction of unlimited Internet access bundled with

A HIGH-CAPACITY NORTH AMERICAN FIBER NETWORK



CALL-NET'S 16,200 ROUTE-MILE FIBER OPTIC NETWORK CONNECTS THE MAJOR COMMERCIAL AND RESIDENTIAL CENTERS OF NORTH AMERICA. THE NETWORK IS BEING EXPANDED THROUGH JOINT BUILDS AND SWAPS.

NETWORK STATISTICS

	Canada	U.S.
Route Miles	7,200	9,000
Strand Miles	116,000	127,000
Route Kilometers	11,600	14,500
Strand Kilometers	187,000	205,000

10 cents a minute long distance calling all day, every day.

The number of cities from which THE MOST™ online is accessible by a local telephone line has been extended from 17 to 41. This will open additional markets and further accelerate growth. In addition, we expect to attract new customers when we introduce high-speed access to compete with cable modems. Our service will allow single-line customers to access the Internet without taking the telephone out of service.

IN JUST OVER A YEAR WE HAVE GROWN TO BE ONE OF CANADA'S LARGEST INTERNET SERVICE PROVIDERS.

Our experience as an ISP is an example of our ability to enter a new market against entrenched suppliers, establish a competitive differential, and build a large customer base in a short period of time.

Local services In 1998 we invested in preparing our entry into local service, a sector that has been under monopoly for most of this century. We began to offer local service in Calgary in February 1999 and expect to roll out in Vancouver, Toronto and Montreal later in the year. Call-Net is the first competitor to offer local service to both

residential and business customers. We believe that we are better positioned than any other new entrant to become the local service supplier of choice for a large range of products and services on a national basis.

At $8.5 billion in annual revenue, the local services market in Canada is bigger than the long distance market. Our large commercial and residential customer base in long distance, business data and Internet services gives us the critical mass to compete against the monopolists. Our market research suggests that we can expect strong demand from current customers, who spend more than $1.5 billion a year on local services. We have a sales and service force in place across Canada to manage our city-by-city marketing campaign. Consequently, our incremental costs to acquire customers are expected to be below those of other new entrants.

As part of our build out, we signed an agreement in 1998 with Lucent Technologies to provide and finance our local network technology, equipment and software. By 2001, we expect to be operating in 25 markets with the ability to connect to 12 million access lines, or more than 65 percent of the Canadian market.

CALL-NET IS THE FIRST COMPETITOR TO OFFER LOCAL SERVICE TO BOTH RESIDENTIAL AND BUSINESS CUSTOMERS.

Overseas services In the fourth quarter of 1998, we were freed from the obligation to use Teleglobe's facilities for inbound and outbound overseas calls. In fact, we were the first company to respond to the termination of the Teleglobe monopoly.

More than one billion minutes of telecom traffic flows annually from Canada to overseas markets. Our customers represent about 30 percent of this volume. By establishing direct relationships with foreign carriers, we will lower operating costs and

improve margin for outbound calls. We will also negotiate our own rates for inbound traffic, a totally new revenue source. As international calling is price elastic, we anticipate stronger revenue growth as a result of competition.

To take further advantage of these opportunities, we have expanded our gateway switch in New York City, acquired trans-Atlantic cable capacity, and established switching equipment in London to access the European market. This $20 million investment in 1998 has an expected payback of two years.

We plan to extend our network into Asia in 1999 and subsequently into Latin America.

OUR CANADIAN LONG DISTANCE FIBER NETWORK MAKES CALL-NET A LOW-COST CARRIER AND GREATLY ENHANCES OUR COMPETITIVE POSITION.

Fiber networks Our Canadian long distance fiber network is now fully operational and connects all major markets from coast to coast. This high-capacity network, with 7,200 route miles and 116,000 strand miles, makes Call-Net a low-cost carrier and greatly enhances our competitive position.

Our U.S. long distance network will be on-stream in the first quarter of 2000. With 9,000 route miles and 127,000 strand miles, the network is one of the largest in the United States and will connect most major urban centers as well as smaller markets. This network capacity opens additional opportunities to grow in the large U.S. market.

The Canadian and U.S. networks incorporate ring architecture making them highly reliable as calls can be re-routed instantaneously in the unlikely event of an interruption on a section of fiber. Furthermore, the integrated networks mean that we can carry traffic on our own facilities throughout most of North America and hand it off locally at substantially lower costs.

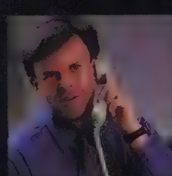
Juri Koor

Phil Bates

Jim Hardy

Vince Salvati

Jean Brazeau



Brock Robertson

Mark Hemingway

Michael Sharp

Barry Singer

Victoria Walker

Ken Wilson

An 11-member executive team and approximately 300 managers are responsible for implementing our growth strategy.

The Company is led by individuals with deep experience in telecommunications and senior corporate management:

Juri Koor, Chairman, President and Chief Executive Officer
More than 25 years experience in the data processing, manufacturing, financial services and telecommunications industries in Canada, the United States and overseas. Assumed leadership of Call-Net in 1991.

Phil Bates, Senior Vice President and President, Sprint Canada
Extensive experience in the U.S. and Canadian telecommunications industry. Joined Call-Net as vice president of network services in 1990. Held other senior positions before being appointed President of Sprint Canada Inc. in 1996.

Jim Hardy, Senior Vice President, Corporate Development
Joined Call-Net in 1992, appointed vice president of corporate development, served two years as chief financial officer. Has more than 15 years experience in communications finance and systems design with three previous companies.

Vince Salvati, Senior Vice President and Chief Financial Officer
Former executive officer at AT&T in the United States and chief financial officer of Bell Canada. Over 28 years of financial experience, more than half in the communications industry. Joined Call-Net in December 1998.

Jean Brazeau, Vice President, Regulatory and Government Affairs
Joined Call-Net in 1993 with responsibility for regulatory matters and government liaison after more than 15 years dealing with regulatory issues at other telecommunications companies.

Mark Hemingway, Vice President, Law and Assistant Secretary
After a six-year career in commercial litigation with one of Canada's leading law firms, joined Call-Net in 1994 and is responsible for all legal matters.

Brock Robertson, Vice President and Treasurer
After managing the treasury operations of a multinational public company, joined Call-Net in 1992. Responsible for managing capital structure, banking relations, currency and interest rate hedging, and financial risk.

Michael Sharp, Senior Vice President, Sprint Canada
Brought 18 years of corporate and agency marketing, sales and advertising expertise to Sprint Canada in 1994. Responsible for residential and SOHO (small office/home office) marketing sales and service.

Barry Singer, Vice President, Administration and Special Projects
More than 20 years experience with telecom companies and other development-phase firms. Expertise in legal, regulatory, human resources and business development issues. Joined Call-Net in February 1999.

Ken Wilson, President, Enterprise Marketing Sales and Service, Sprint Canada
More than 20 years sales and executive management experience in high technology with companies like IBM, Amdahl and Oracle. Joined Sprint Canada in 1996 with responsibility for business and government customers.

Victoria Walker, (Acting) Vice President, Human Resources
Ten years as an HR professional in manufacturing, service and retail companies, as well as the public sector, before joining Call-Net in 1997 with responsibilities for recruitment, development and learning, compensation and benefits.

Call-Net's corporate governance practices are designed to create shareholder value. They engage the board of directors in the Company's rigorous strategic planning process and align the financial interests of senior management with those of investors.

The planning process

Call-Net's strategic planning process has been in place since 1991 and has enabled the Company to grow in a rapid and orderly manner.

The process begins each January with a three-day retreat for directors and senior managers. (Agreeing to attend the annual retreat is a condition of nomination to the Call-Net board.) The first day of the retreat involves a visit to telecommunications facilities in Canada or the United States. In the two subsequent days, the directors and executives focus on topics such as customer markets, geographic opportunities, new products and trends, industry structure and competitors, regulatory issues and acquisition prospects. Outside experts participate as appropriate.

The strategic planning process also identifies Call-Net's principal risks and the policies and systems, such as internal audit and information management systems, necessary to manage those risks.

The strategic plan discussed by the board in January is converted into an action plan by management at a retreat in late May and is reviewed again by the full board in September. The planning process also includes updated forecasts that are reviewed by the directors in May, July and November.

Budgets and performance targets are set for the coming year in November and updated for major strategic changes in February. The directors analyze variances to the business plan and budgets at 10 regular board meetings a year. In 1998, the board held additional meetings relating to the acquisition of *f*ONOROLA Inc., the financing of that transaction, and changes in the Company's capital structure.

Call-Net's disciplined planning, forecasting and review process enables the directors to assume effective stewardship of the Company and to oversee the performance of management.

Alignment of interests

The planning process focuses management on enhancing shareholder value. The compensation program aligns the financial interests of management with those of shareholders. Salaries are set at the median for the telecommunications industry and senior executives can double their annual cash compensation by exceeding corporate performance targets approved by the board. If revenue and profit targets are not reached, bonuses are reduced or not paid. Other managers can also substantially increase their annual cash compensation by meeting individual and corporate targets.

In 1998, 59 senior managers, and 26 sales people who met their targets, were awarded stock options. In addition, approximately 500 employees participated in the company-supported share purchase program. The program is being improved to encourage more employees to become Call-Net shareholders.

Succession planning

A senior management succession plan is in place and is reviewed twice a year by the compensation and human resources committee. This committee identifies with the CEO the management needs for the coming year to ensure executive leadership skills keep pace with Call-Net's diversification into new telecommunications sectors and geographic markets as well as its maturation as a public company.

Board independence

Call-Net does not have a controlling shareholder and eight of the nine board members are unrelated directors as defined in The Toronto Stock Exchange *Guidelines for Improved Corporate Governance.* They are independent of management and free from any interest, business or relationship that materially interferes with their ability to act in the best interests of the Company other than interests and relationships arising from shareholding.

The sole related director is the president and chief executive officer, who is also chairman of the board, although he does not sit on board committees. The duties of the CEO are itemized in Call-Net's *Corporate Governance Manual* adopted by the board in November 1997. The CEO's duties focus on maximizing shareholder value through a long-term vision, strategic plan, ethical corporate culture, annual business plan and budgets, and effective management team. The CEO's performance is

measured by the board's corporate governance and nominating committee against annual and long-term standards and goals.

Three Call-Net directors are senior executives with Sprint Corporation of Kansas City, Missouri. In 1993, Call-Net paid approximately $60 million for the Canadian rights to Sprint's brand name, products, technology and know-how in its long distance business. Sprint took the payment in the form of a special class of non-voting Call-Net shares that do not trade on any stock exchange and at the time represented about 25 percent of the outstanding equity. Sprint has since participated in every Call-Net equity offering to maintain its ownership at approximately 25 percent. Sprint has the right to appoint one-third of Call-Net's directors as long as it maintains its proportionate equity position. Call-Net also agreed in 1993 to pay a royalty based on two percent of net income up to a maximum of $15 million a year. Royalty payments are not cumulative and cannot put Call-Net in a negative profit position before tax.

The Sprint-appointed directors understand they are fiduciaries of an independent company that has the freedom to compete in any market provided it does not use the Sprint brand, know-how or technology outside of the terms of the Canadian agreement. Having three executives of a world-leading telecommunications company as directors provides Call-Net with insights into U.S. and global telecommunications trends.

Director compensation

Each director is entitled to a $12,000 annual stipend and $1,000 per board meeting. Committee chairs receive an additional $7,500 annual stipend. Directors can receive their fees in cash or stock options. The Chairman does not receive fees.

Directors are reimbursed for expenses and any director may engage an outside advisor at Call-Net's expense in appropriate circumstances.

Board evaluation

Call-Net introduced a new board and director evaluation process in 1998. Each director completes an annual questionnaire on the effectiveness of the board, its mix of skills and expertise, the recruitment process, the orientation program, the frequency of board meetings, quality of information, and thoroughness of discussions. Directors are questioned on their involvement in the strategic planning process, the ethics of the Company, the adequacy of safety and environmental programs, the identification of principal risks and risk management systems, and their relationship with management. The directors also rate the effectiveness of board committees.

The directors rate each other's performance in terms of interpersonal skills, industry awareness, being alert and inquisitive, board participation, contribution to long-range planning and other criteria.

Board committees

The independence of board committees is assured by excluding the CEO as Chairman from membership on all committees and the three Sprint directors from the corporate governance and nominating committee.

The three-member **audit committee** reviews financial controls and risk management, reporting procedures, internal controls and the performance of the external auditors. An internal audit function was established in 1998, reporting to the audit committee through the chief financial officer. The committee meets with the external auditors without management present. This committee met five times in 1998.

The three-member **human resources and compensation committee** reviews executive and director compensation, including incentive-based compensation programs for management. It establishes measurable performance criteria and oversees the search for senior managers. This committee met six times in 1998.

The five-member **corporate governance and nominating committee** establishes formal corporate governance guidelines and practices, reviews the credentials of board members and nominees, recommends candidates for nomination, and sets guidelines for the education and orientation of new board members. This committee met twice in 1998.

Communications policy

Call-Net has a proactive communications policy in dealing with governments, regulators, and investors in Canada and the United States. Senior executives are involved on a continuous basis in making presentations to stakeholders and other parties, and the Company is committed to full and timely disclosure of material events and financial results.

Call-Net Enterprises Inc. is an experienced telecommunications carrier with a large marketing and customer service organization and network facilities in Canada, developing network assets in the United States, and a company-owned link to Europe.

The following discussion and analysis explains trends in the Company's financial condition and results of operations for the year ended December 31, 1998 compared with previous years, and is intended to help shareholders and other readers understand the dynamics of the Company's business and the key factors underlying its financial results. Certain statements in the Annual Report and in this management's discussion and analysis constitute forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, the following: general economic and business conditions, demographic changes, regulation, major technology changes, timing of product introductions, competition, and the ability of the Company to attract and retain key employees. The consolidated financial statements, notes to the consolidated financial statements and supplementary information constitute an integral part of and should be read in conjunction with this management's discussion and analysis.

A Brief History

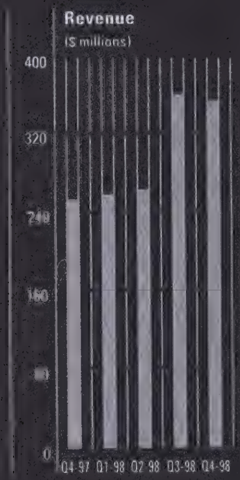
From its incorporation in 1986 until 1994, the Company offered primarily outbound long distance voice services to small and medium-sized businesses in four Canadian provinces. Our growth has been extremely rapid in the past five years following the opening of long distance to full competition. By 1995, we offered a full range of long distance and data services to businesses of all sizes, as well as long distance services to other carriers and residential customers. By 1996, we operated in all Canadian provinces and in 1997 added Internet access for consumers and businesses.

In 1998, we consolidated our position as Canada's largest national long distance and data service competitor to the entrenched telephone companies. With the acquisition of *f*ONOROLA Inc. ["the *f*ONOROLA acquisition"], we further strengthened our customer list and sales and customer service resources, and gained a national fiber optic network that we completed in April 1999. The *f*ONOROLA acquisition also gave us entry into the United States, a market more than 10 times the size of Canada, where we will complete a fiber optic network over the next 12 months.

In early 1999, we established our own competitive overseas service, following the end of Teleglobe's monopoly of Canada's overseas telecom traffic, and began to form direct relationships with foreign carriers for the termination of their inbound overseas traffic in North America. We also entered the last area of monopoly in Canadian telecommunications by offering local service, with Calgary selected as our first local service market in a planned national roll out.

Growth Strategy

Call-Net has followed a controlled growth strategy. We develop products that will deliver measurable value to a target customer segment, such as residential users or large corporations, and then roll out the product offering in sequential geographic markets. Once we are established in a customer segment, we expand the product offering to other



customer groups and geographic areas. Throughout, the emphasis is on customer service.

Our goal in Canada is to be the number one competitor to the entrenched telephone company in each customer segment or geographic market within five years of entry. We are the competitive choice in all Canadian long distance markets, with an 18 percent national share of switched long distance; the second largest Internet service provider; and on target to achieve a similar status in the high-speed business data market, where we more than doubled our revenue in 1998. In the case of local service, we plan to win at least a 15 percent share of the markets we enter within five years.

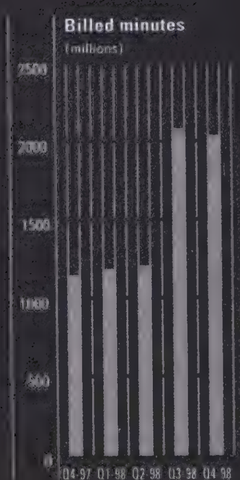
Core Competencies

Call-Net's competitive position is based on core competencies and corporate strengths developed over several years. They include:

- being first and foremost a marketing company focused on customer value and solutions;
- using technology as a means to deliver cost-effective customer services;
- implementing marketing strategies to achieve an early critical mass of market share;
- maintaining multiple distribution channels, including local and regional sales offices, a major accounts sales force, and outbound telemarketing;
- operating customer care call centers designed to handle large volumes of business;
- developing scaleable platforms for business and residential billing systems and telecom management reports for business customers;
- operating a low-cost service structure;
- ensuring network quality and reliability through in-house network management centers;
- managing a customer base of more than 1.3 million households and business locations;
- competing successfully against large and vertically integrated incumbent telephone companies; and
- maintaining a conservative financing approach by pre-funding each new phase of major growth.

In developing these core competencies and corporate strengths, we have matured from simple products, such as long distance voice and toll free service, to complex solutions, such as our high-speed business data platform that delivers comprehensive solutions to corporate clients.

These strengths enable us to continue growing our existing businesses in long distance and data services while pursuing new opportunities in local service and overseas service, as well as in the United States.



Financial Results

In 1998, Call-Net continued to make strong revenue gains. However, higher carrier charges, increased contribution costs and more intense price competition caused a decline in our gross margin percentage from the 1997 level. We also invested heavily in the future through the fONOROLA acquisition and the development of new services and network assets, resulting in a net loss for the year.

Revenue and traffic volume Revenue increased by 33 percent to $1.2 billion in 1998, including approximately $200 million from the fONOROLA acquisition completed on June 27, 1998.

More than 85 percent of revenue is from switched long distance services. We continue to experience steady growth in the Canadian long distance market, especially from corporate customers. Business revenue grew by 48 percent in 1998. Residential long distance revenue grew by nine percent despite more competitive pricing programs. In our view, long distance prices will continue to fall over the long term, especially as customers opt for long distance, local, data and other services on a bundled and flat rate basis.

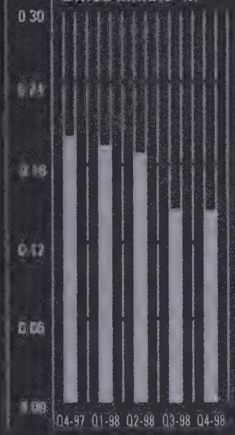
Business data services are a relatively new income stream for Call-Net and showed solid growth in 1998 with revenue doubling to $125 million. Major corporations and governments are impressed by the quality and reliability of our network; the industry-leading speed of our services such as Internet backbone access and private line; the excellence of our customer service; and our emphasis on delivering complete business solutions to their needs.

A new revenue source is Internet access for consumers and small businesses subscribing to THE MOST™ online. This service was launched in September 1997 and ended 1998 with more than 140,000 customers, generating revenue in excess of $20 million. Growth should accelerate following the introduction in early 1999 of unlimited Internet access bundled with 10 cents a minute long distance calling all day, every day. We have also extended dial-up access to 41 centers across Canada in 1999, compared with 17 at the start of 1998.

The volume of switched voice and data traffic carried on our national network grew to 6.5 billion billed minutes, versus 4.1 billion in 1997. Due to the popularity of flat rate long distance pricing programs, such as THE MOST™ by the month, billed minutes are becoming less and less relevant in measuring performance as they are no longer directly linked to revenue performance. The shift to a highly competitive flat rate market is evident in the decline of revenue per minute to 18.9 cents for 1998, compared with 22.6 cents in 1997 and 25.4 cents 1996.

Revenue increased in every quarter during 1998 compared with 1997, gaining momentum in the second half of the year with the fONOROLA acquisition. The fourth quarter revenue was 40 percent higher than the last quarter of 1997, giving Call-Net an annualized revenue run rate of $1.4 billion entering 1999.

Switched revenue per Billed minute ($)



Carrier charges and gross margin Carrier charges increased by 56 percent to $788 million, producing a gross profit of $440 million, a six percent improvement over 1997. Gross margin was 36 percent of revenue, compared with 45 percent a year earlier. On a quarterly basis, gross margin declined from 42 percent of revenue in the first two quarters to 31 percent in the last two quarters.

One reason for the higher margin in the first half of the year was reduced contribution rates paid to the telephone companies to subsidize their local rates. In the second half of the year, however, the savings on base contribution were offset by higher net contribution charges due to the end of the new entrant contribution discount, coupled with growth in minutes.

The base contribution rate is levied on a per minute basis for access to the public telephone system. Our introduction of a flat rate long distance plan increased billed minutes and contribution charges without an equivalent increase in revenue, further decreasing margin. Initially, we offered unlimited long distance calling, but subsequently capped our offering at 800 minutes for $20 per month to resolve network congestion and reduce the impact on gross margin. We have argued before the CRTC that a per minute contribution

Gross margin
(% of revenue)

tariff no longer makes sense in a flat rate environment. In response, the CRTC has scheduled a proceeding later this year and declared the current contribution rates as "interim".

The deployment of our fiber optic network in April 1999 and the elimination of the Teleglobe monopoly on overseas traffic are expected to reduce our transport costs. At the same time, we are gaining revenue from higher data sales to large corporations and government and the re-assertion of our marketing leadership among residential customers. A recent example of our renewed market leadership was the launch in January 1999 of unlimited Internet access combined with 10 cents a minute long distance calling all day, every day.

In addition, the *f*ONOROLA acquisition has strengthened our position in the carrier or wholesale market, where gross margins are lower than in other markets we serve.

Operating costs Operating costs increased by 17 percent to $380 million in 1998. We invested in growing our long distance, business data and Internet access services as well as preparing our 1999 entry into local service and overseas service. As a percentage of revenue, operating costs averaged 31 percent, compared with 35 percent in 1997 and 32 percent in 1996.

At the 1998 year end, annualized revenue per employee was approximately $499,000, compared with $506,000 a year earlier. We employed approximately 2,800 people and continue to increase employment levels in Canada as we expand all aspects of our business. To accommodate higher staffing levels and ensure operating efficiencies, we will consolidate Toronto area staff in a multi-building head office campus being developed on a 50-acre site near our current head office. The project will be completed over several years.

EBITDA Earnings before interest, taxes, depreciation and amortization were a negative $22 million in 1998, compared with a positive $91 million in 1997. The 1998 EBITDA included $39 million spent on developing new local and overseas services as well as the ramp up of Internet services, plus an $82 million integration and restructuring charge in the second quarter in connection with the *f*ONOROLA acquisition (see Note 2 to the Financial Statements).

When new development costs and the integration and restructuring charge are excluded, EBITDA from core long distance and data services was $99 million, or eight percent of revenue, compared with $126 million, or 14 percent of revenue, in 1997.

The current cycle of developing and launching new businesses is having a similar impact on EBITDA as did our expansion strategy in mid-1994. At that time, we invested heavily over a period of 18 months in offering new products to residential and business customers and building a critical economic mass in each province. Those expenditures involved infrastructure for the national telecommunications network, information management systems, new products, customer service, order fulfillment services and human resources. Positive EBITDA was neither anticipated nor achieved until the fourth quarter of 1995.

We expect a similar pattern of growth as we phase in our national offering of local service over the next three years, establish a competitive overseas service, rapidly expand our market coverage for Internet access, and complete our long distance fiber optic networks in Canada and the U.S. The advantage this time is our ability to leverage substantial technological and customer service assets, established sales and marketing channels, and a large customer base.

Depreciation and amortization Depreciation and amortization increased by $65 million to $112 million, reflecting an $822 million increase in fixed assets and a $1,445 million increase in other assets.

Interest expense Interest expense was $100 million in 1998, compared with $40 million in 1997. The increase was the result of new financing completed in July 1998 consisting of U.S. denominated Senior Notes and Senior Discount Notes for cash consideration of approximately $687 million, which was used to repay the bridge financing incurred to fund the *f*ONOROLA acquisition. In August 1998, subsequent to the closing of the acquisition, we redeemed the Senior Secured Notes of *f*ONOROLA for US$134 million.

The Company maintains a policy of investing surplus cash in highly liquid, secure money market instruments. At December 31, 1998, cash and short-term investments totaled $189 million, compared with $558 million a year earlier. Interest income for the year was $13 million versus $12 million in 1997.

Net income Call-Net reported a net loss of $237 million, or $3.32 per share, compared with net income of $16 million, or 31 cents per share, in 1997.

The 1998 loss reflected the $39 million invested in new services and expensed during the year; the $82 million integration and restructuring charge related to the *f*ONOROLA acquisition; and a further foreign exchange translation loss of $16 million on the refinancing of the bridge loan related to the acquisition.

The 1997 net income was after payment of $15 million in royalties to Sprint Communications Company L.P. for use of Sprint's brand name, products, technology and know-how in our long distance business.

Liquidity and Capital Resources

At the 1998 year end Call-Net had approximately $189 million of short-term investments, $400 million of vendor financing to fund our Canadian local service roll out (subject to maintenance of certain financial covenants, which were not met at year end), unused portion of a bank facility of $16 million, and cash flow from the long distance and data services business.

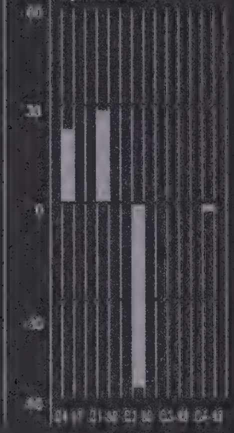
Capitalization In June 1998, Call-Net acquired *f*ONOROLA Inc. for $1.8 billion, consisting of $710 million of Class B non-voting shares and $1.1 billion in cash. In July 1998, we raised $219 million from the sale of 8.8 million Class C non-voting shares to Sprint Communications Company L.P. when it exercised its right to maintain its ownership of Call-Net at approximately 25 percent.

Also in July, we raised $687 million from an issue of Senior Notes and Senior Discount Notes. The proceeds were used to repay bridge financing incurred in the *f*ONOROLA acquisition.

Capital expenditures Capital expenditures totaled $482 million, compared with $104 million in 1997.

We invested approximately $390 million in long distance and business data services, including the development of our long distance fiber optic networks in Canada and the

Cash flow from operations ($ millions)



United States, and in upgrading information management systems and improving infrastructure. The high-capacity fiber networks provide more than 16,000 route miles and 243,000 strand miles of fiber. The Canadian routes are complete and the U.S. routes are being phased in over the next 12 months.

Approximately $75 million was invested during 1998 to introduce local services in major centers across Canada, on expanding our Internet business, and on establishing our overseas service, including expansion of our gateway switch in New York City, trans-Atlantic cable capacity, and switching equipment in London.

Net capital assets grew by $711 million to total $953 million at year end. Assets include the fiber networks and major switching equipment in Canada, the United States, the U.K. and under the Atlantic Ocean; a national data network management center in Vancouver; a national voice network management center in Toronto; three customer service centers; information management systems; and 17 offices across Canada.

Cash flow Consolidated cash flow, before financing activities and the fONOROLA acquisition, was a negative $303 million, versus a positive $34 million a year earlier, as a result of much higher capital spending on the development and launch of new services, the completion of the Canadian fiber optic network, and the continued development of the U.S. fiber optic network.

Cash flow from operations was a negative $30 million, compared with a positive $99 million in 1997. After working capital changes, cash flow was a negative $74 million versus $139 million in 1997.

Year-end position Call-Net concluded 1998 with $189 million of short-term investments. These funds, combined with the cash flow from core services, will help to finance our national roll out of local service. The agreements we signed in 1998 with Lucent Technologies to provide our local network technology included $400 million in vendor financing.

When we completed the financing of the fONOROLA acquisition in 1998, we strengthened our balance sheet in readiness for our next period of growth with our debt-to-equity ratio improving to 1.4:1 versus 1.9:1 at the end of 1997.

Call-Net had available for use $16 million of its credit facility of $75 million as at December 31, 1998.

Capital assets ($ millions)

Investments

We own 11 percent of Microcell Telecommunications Inc., a Montreal-based company that was awarded a federal licence in December 1995 to develop a digital wireless PCS telephone service across Canada. Microcell developed its network and began to offer PCS service in major urban centers in 1997. At the end of 1998 it had approximately 282,000 subscribers.

Risks and Risk Management

Call-Net faces several competitive, regulatory, operating and financial uncertainties. Operating and financial strategies, and the deployment of resources, are designed to offset these potential risks.

Competitive risks The Canadian telecommunications industry continues to undergo fundamental change. At the beginning of 1998, there were four major national long distance carriers – the Stentor alliance of former monopoly telephone companies and three alternative suppliers. By the beginning of 1999, the Stentor alliance was in the process of disintegrating, Call-Net had acquired one of its national competitors, and the remaining alternative company had apparently come under foreign control and was in the process of combining with two other competitors. The result was still four major national long distance players in different forms, as well as smaller but significant competitors in certain large urban centers. Our primary competitors, however, continue to be the former Stentor vertically integrated telephone companies that operate in each provincial or regional market. At the start of 1999, these companies continued to dominate long distance and monopolize local service.

We will manage competitive risks in Canada by expanding our product offerings to bundle local, long distance and data services on a basis similar to the telephone companies. In the United States, we face competition from large and well-established local and long distance companies. Our growth strategy will replicate our experience in Canada by developing products targeted at specific customer segments in limited geographic markets and developing a critical mass of customers and revenue before expanding into new products, customer segments and geographic areas.

We also manage competitive risks by being well funded with a conservative balance sheet; by maintaining our operating and capital costs well below those of major competitors; by leveraging our relationship with Sprint U.S. to access forward-thinking know-how, technology, services and intellectual property; and by offering products and services with a strong value proposition for customers.

Legal and regulatory risks The ownership and management of Call-Net and Sprint Canada are subject to the provisions of the *Telecommunications Act* (Canada). The Act restricts foreign ownership of a telecommunications carrier to 20 percent, and indirect ownership through a holding company to 33.3 percent. According to that Act, a carrier cannot be otherwise controlled by a foreign entity. However, while Call-Net and Sprint Canada are currently in compliance with these ownership and control requirements, competitors appear to have now effectively circumvented these restrictions.

Year 2000 readiness The Year 2000 issue represents a significant challenge to Call-Net, as its business is highly dependent on complex systems and technology, some of which have date sensitive elements. The issue could impact many of the Company's operations, including the products and services it provides to customers, its internal systems and support and its network (both its own and those of others with which it interconnects). As a result, Call-Net considers Year 2000 readiness an important component of service to customers and recognizes that it is important to them in their daily operations and planning cycles.

Call-Net and its operating subsidiary, Sprint Canada, established a Year 2000 Program Management Office in 1997. The Program sponsor for the Year 2000 Readiness Program is a Senior Vice President of Call-Net. The Program Management Committee, comprised of senior management from every functional area of the Company, meets regularly to review progress. The Project Director provides regular updates to the Board of Directors.

Our Year 2000 Readiness program identified ten steps for successful completion: (1) Executive Sponsorship; (2) Awareness and Communications; (3) Inventory and Assessment; (4) Risk Analysis; (5) Solution Design; (6) Build Solution; (7) Testing; (8) User Acceptance Testing and Sign-off; (9) Production Implementation; and (10) Strict Change Management and Contingency. All steps are now complete for Sprint Canada with the exception of Contingency. The Company believes that network systems and business processes within Sprint Canada's control are now Year 2000 ready. The Company is currently migrating customers acquired in the fONOROLA transaction to Sprint Canada Year 2000-ready systems. For the fONOROLA systems which will be integrated, the Company intends to achieve Year 2000 readiness within the second quarter of 1999. The Company is in the process of developing and implementing Year 2000 business continuity plans to address contingencies. Business continuity plans are planned for completion and testing in the third quarter of 1999. Our plan is to aggressively implement our Year 2000 Program to ensure a minimum six-month contingency window prior to the millennium change.

Through the remainder of 1999, as systems continue to be upgraded and implemented in the normal course of business, the Company will continue to retest and recertify such systems to ensure continued Year 2000 readiness. Total costs associated with the Year 2000 project, including fONOROLA remediation costs, are expected to be approximately $25 million (of which approximately $16 million have been incurred to date), although actual costs could differ materially from these expectations. Expenses are being treated as capital or operating based on the underlying nature of the cost.

The Company believes that at this time its major risk associated with the Year 2000 issue is the ability of its key business partners and suppliers to resolve their Year 2000 issues. Many of the Company's applications and systems interact with those of customers and other third parties which are beyond the Company's control. The Company is thus highly dependent on third parties which provide it with critical products and services. The Company continues to communicate with such third parties, including major suppliers and other telecommunications carriers, to determine its vulnerability to and, where possible, to mitigate against any failure on the part of such third parties to remediate their own Year 2000 issues. Progress of these third parties is being monitored. The Company is in the process of testing its external interfaces and services and has implemented a strict change management procedure to maintain the Year 2000 readiness of tested systems, applications and components and to ensure the readiness of new systems, applications and components.

Most of the calls carried by the Company's network are completed on other networks which are beyond the Company's control. Sprint Canada is participating in the Canadian Telecommunications Industry Forum, which is addressing domestic network interoperability issues. All domestic network interoperability testing with other carriers was completed in the first quarter of 1999 and test results are currently being evaluated. For international network interoperability issues, we are working with our North American and global partners in the International Telecom Forum.

The Company believes that it has an appropriate Year 2000 readiness plan in place. However, there can be no assurance that the products or systems of other companies that Sprint Canada or its customers utilize, or on which they rely, will be made ready in a timely

and effective manner, or that a failure to be Year 2000 ready by another company would not have a material adverse effect on the Company's financial condition and results of operations and on its customers. The Year 2000 issue is a unique event which raises unusual and special challenges and risks. The Company believes that by remediating and replacing software systems, where required, and by monitoring the Year 2000 readiness of third parties, the Year 2000 issue can be mitigated. However, if (i) such remediation and replacement are not completed on a timely basis; (ii) any of the Company's key suppliers fail to deliver Year 2000 ready products and services; (iii) products or systems of other companies which the Company or its customers utilize or rely on are not converted in a timely or effective manner, or such conversion is not compatible with the Company's systems; or (iv) the Company's contingency plans are ineffective, the Year 2000 issue could have a material adverse effect on the financial condition and results of the Company.

Financial risks Call-Net's core services, taken as a whole, are now self-financing. During the next few years Call-Net will be investing in areas, such as online and local services in Canada; the U.S.; and internationally, where the returns are uncertain and it could take several years for the new activities to be self-financing. In addition to cash flow from core services, the Company had short-term investments of $189 million, a $400 million vendor facility for the local service network, (subject to maintenance of certain financial covenants , which were not met at year end) and $16 million available from its $75 million bank credit line.

The balance sheet is managed conservatively, with a debt to equity ratio of 1.4:1 in 1998. Some risk is attached to four issues of U.S. dollar denominated Senior Discount Notes and Senior Notes, although the majority of the foreign currency exposure is hedged. This is disclosed in note 13b to the consolidated financial statements.

Future Expectations

The management of Call-Net remains focused on achieving superior long-term shareholder returns.

We are committed to growing revenue from a broad offering of local, long distance, overseas, Internet access and business data services.

At the same time, we are committed to reducing operating costs faster than the long-term decline in telecommunications prices by operating high-efficiency and high-capacity fiber optic networks in Canada and the United States, with company-owned connections internationally.

Call-Net prides itself on being a marketing company that is customer focused. Our strategy of developing products that respond to the needs of a customer segment, and rolling out those products on a market-by-market basis, has proven successful in the past and will shape our future growth.

In 1999, we expect our core business in long distance and data services to grow rapidly and sustain its profitability. At the same time, we expect measurable quarter-by-quarter growth in revenues from Internet, local and overseas services as we develop a critical mass of customers for these services.

MANAGEMENT'S REPORT

Management is responsible for the preparation and presentation of the consolidated financial statements and all other information in the annual report. This responsibility includes the selection of appropriate accounting methods, in addition to making the judgements and estimates necessary to prepare financial statements in accordance with generally accepted accounting principles. It also includes ensuring that the other financial information presented elsewhere in the annual report is consistent with the financial statements.

To safeguard assets and to provide reasonable assurance that relevant and reliable financial information is being produced, management maintains a system of internal controls. The financial statements have been audited by the independent shareholders' auditors, Ernst & Young LLP, whose report follows.

The Board of Directors, acting through an Audit Committee, is responsible for determining that management fulfills its responsibilities in the preparation of financial statements and the financial control of operations. The Board of Directors recommends the independent auditors for appointment by the shareholders. The Audit Committee meets regularly with financial management and the independent auditors to discuss internal controls, auditing matters and financial reporting issues. The independent auditors have unrestricted access to the Audit Committee. The Audit Committee reviewed the consolidated financial statements and management's discussion and analysis prior to the Board approving them for inclusion in the annual report.

Juri Koor

Juri Koor *President and Chief Executive Officer*

Vincent Salvati *Senior Vice President and Chief Financial Officer*

AUDITORS' REPORT

To the Shareholders of
Call-Net Enterprises Inc.

We have audited the consolidated balance sheets of **Call-Net Enterprises Inc.** as at December 31, 1998 and 1997 and the consolidated statements of operations and deficit and cash flows for each of the years in the three-year period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for each of the years in the three-year period ended December 31, 1998 in accordance with accounting principles generally accepted in Canada.

Ernst & Young LLP

Toronto, Canada,
February 16, 1999.

Ernst & Young LLP *Chartered Accountants*

CONSOLIDATED BALANCE SHEETS

As at December 31 (millions of Canadian dollars)	**1998**	1997
ASSETS		
Cash and short-term investments	**189.3**	558.4
Accounts receivable	**235.1**	141.9
Total current assets	**424.4**	700.3
Capital assets [note 3]	**953.1**	242.6
Other assets [note 4]	**1,496.8**	110.6
Total assets	**2,874.3**	1,053.5
LIABILITIES AND SHAREHOLDERS' EQUITY		
Bank indebtedness [note 5]	**41.8**	—
Accounts payable and accrued liabilities	**515.4**	198.0
Total current liabilities	**557.2**	198.0
Long-term debt [note 6]	**1,332.7**	564.9
Contingencies [note 10]		
Shareholders' equity		
Capital stock [note 7]		
Common Shares, unlimited authorized	**124.8**	124.8
Class B Non-Voting Shares, unlimited authorized	**862.4**	151.3
Class C Non-Voting Shares, unlimited authorized	**347.8**	128.4
Deficit	**(350.6)**	(113.9)
Total shareholders' equity	**984.4**	290.6
Total liabilities and shareholders' equity	**2,874.3**	1,053.5

See accompanying notes

On behalf of the Board:

Robert Crockford
Director

Alan R. Abraham
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

Years ended December 31 (millions of Canadian dollars, except per share amounts)	1998	1997	1996
Revenues	**1,227.6**	920.9	712.6
Carrier charges	**787.7**	505.7	444.7
Gross profit	**439.9**	415.2	267.9
Operating costs	**380.2**	324.7	224.8
Integration costs [note 2]	**81.7**	—	—
Earnings (loss) before interest, taxes, depreciation and amortization	**(22.0)**	90.5	43.1
Depreciation and amortization	**(111.7)**	(46.6)	(33.2)
Operating income (loss)	**(133.7)**	43.9	9.9
Interest on long-term debt	**(99.9)**	(40.0)	(26.1)
Interest and investment income (expense)	**(1.8)**	12.4	9.1
Income taxes	**(1.3)**	—	—
Net income (loss) for the year	**(236.7)**	16.3	(7.1)
Deficit, beginning of year	**(113.9)**	(130.2)	(123.1)
Deficit, end of year	**(350.6)**	(113.9)	(130.2)
Earnings (loss) per share [note 12]	**(3.32)**	0.31	(0.14)

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31 (millions of Canadian dollars)	1998	1997	1996
OPERATING ACTIVITIES			
Net income (loss) for the year	**(236.7)**	16.3	(7.1)
Add operating items not requiring cash:			
Depreciation and amortization	**111.7**	46.6	33.2
Interest on long-term debt	**79.1**	36.5	25.5
Foreign exchange loss on refinancing	**16.3**	—	—
Cash flow from operations before changes in non-cash working capital	**(29.6)**	99.4	51.6
Changes in non-cash working capital balances related to operations:			
Accounts receivable	**69.9**	(22.2)	(27.0)
Accounts payable and accrued liabilities [note 3]	**(114.4)**	61.5	26.0
	(44.5)	39.3	(1.0)
Cash provided by (used in) operating activities	**(74.1)**	138.7	50.6
INVESTING ACTIVITIES			
Investment in fONOROLA Inc. [note 2]	**(1,510.1)**	—	—
Acquisition of capital assets	**(346.7)**	(104.3)	(59.7)
Proceeds on disposal of capital assets	**113.8**	—	—
Investment in Microcell Telecommunications Inc. [note 4]	**—**	—	(7.8)
Other	**3.9**	(0.1)	0.3
Cash used in investing activities	**(1,739.1)**	(104.4)	(67.2)
FINANCING ACTIVITIES			
Issue of capital stock	**930.5**	21.3	10.6
Issue of long-term debt	**686.9**	343.4	–
Repayment of long-term debt	**—**	—	(3.5)
Increase in bank indebtedness	**41.8**	—	—
Repayment of fONOROLA Inc. high yield notes	**(198.0)**	—	—
Debt issue costs	**(17.1)**	(10.7)	—
Cash provided by financing activities	**1,444.1**	354.0	7.1
Net increase (decrease) in cash during the year	**(369.1)**	388.3	(9.5)
Cash and short-term investments, beginning of year	**558.4**	170.1	179.6
Cash and short-term investments, end of year	**189.3**	558.4	170.1

See accompanying notes

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada ["Canadian GAAP"]. These principles are also in conformity in all material respects with accounting principles generally accepted in the United States ["U.S. GAAP"] except as described in note 15 to the consolidated financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Call-Net Enterprises Inc. and its principal operating subsidiaries Sprint Canada Inc. and fONOROLA Inc. ["fONOROLA"], hereafter referred to as the "Company". All the significant intercompany balances and the transactions have been eliminated.

The Company owns approximately 11% of the shares of Microcell Telecommunications Inc. ["Microcell"]. This investment is accounted for using the cost basis as the Company believes it does not exert significant influence over the affairs of Microcell.

Cash and Short-Term Investments

Short-term investments are recorded at the lower of cost and market value.

Capital Assets

Capital assets are recorded at cost. Depreciation on all assets commences when the assets are put into service. Depreciation and amortization are being provided based on the estimated useful lives of the assets on a straight-line basis as follows:

Buildings	15 to 40 years
Fiber optic cable and equipment	20 years
Multiplex and telephone switch equipment	10 years
Computer equipment and software	3 to 5 years
Furniture and fixtures	5 years
Leasehold improvements	term of the lease

Investments

Investments are recorded at cost. A decline in the value of an investment that is considered to be a permanent impairment in value is charged against income in the period that such determination is made.

Other Assets

Goodwill Goodwill, which represents the excess of the purchase price of the Company's interest in subsidiary companies over the fair value of the underlying net identifiable assets of the business acquired, is being amortized on a straight-line basis over 20 years.

Goodwill is assessed for future recoverability or impairment on an annual basis by estimating

future net undiscounted cash flows and residual values. Any permanent impairment of the value of the unamortized portion of goodwill is written down with a charge against income in the period that such determination is made.

Other Intangible Assets Technology and product rights, customer lists, trademarks and other intangible assets are recorded at cost.

Intangible assets are assessed for future recoverability or impairment on an annual basis by estimating future net undiscounted cash flows and residual values or by estimating replacement or appraised values. When the net carrying amount of an intangible asset exceeds the estimated net recoverable amount, the asset is written down with a charge against income in the period that such determination is made.

Amortization of intangible assets is provided on a straight-line basis as follows:

Technology and product rights	10 years
Customer lists	10 years
Trademarks	10 years
Financing costs	term of the financing
Other intangible assets	10 years

Revenue Recognition

Revenues from services are recognized based on either customer usage as measured by the Company's switches or by contractual agreements.

Translation of Foreign Currencies

Foreign currency transactions entered into by the Company and the accounts of its U.S. subsidiaries are translated into Canadian dollars using the temporal method. Under this method, monetary assets and liabilities in U.S. dollars are translated into Canadian dollars at the year-end rate of exchange and any gains or losses are reflected in income. Capital and other assets, and liabilities are translated at rates prevailing at the time of the transaction. Revenues and expenses are translated into Canadian dollars at the rate of exchange prevailing at the time of the transaction, except for depreciation and amortization, which are translated at exchange rates prevailing when the related assets were acquired. Long-term debt denominated in U.S. dollars is translated into Canadian dollars at the year-end rate of exchange, or at the hedged rate of exchange if cross-currency interest rate swaps are in effect. Exchange gains or losses on translating this long-term debt are deferred and amortized on a straight-line basis over the remaining term of the debt.

Derivative Financial Instruments

The Company purchases services from U.S. based telephone carriers to terminate southbound traffic in the normal course of business. The Company has a foreign exchange hedge program including use of forward exchange contracts to manage the risk of this foreign currency denominated liability. Exchange gains or losses associated with this program are included in income as incurred.

The Company is party to long-term cross-currency interest rate swap agreements to manage risks associated with the Senior Discount Notes. Any net cost or benefit associated with such agreements is recorded on an accrual basis as an adjustment to interest expense. The costs associated with entering into the cross-currency interest rate swaps are being amortized over the term of the loan on a straight-line basis.

Income Taxes

Income taxes are accounted for using the deferred tax allocation method under which the income tax provision is based on the income reported in the accounts.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

2. ACQUISITION

On June 27, 1998, the Company acquired 100% of fONOROLA, a facilities-based carrier of long distance voice and data telecommunications services, for consideration of $1,797.9. The acquisition was accounted for using the purchase method, and the results of operations were included in these consolidated financial statements from the date of acquisition. The purchase price was allocated to the net identifiable assets acquired based on their estimated fair market values as follows:

	June 27, 1998
Net assets acquired:	
Working capital, including cash of $287.8	159.2
Capital assets	404.7
Goodwill	1,302.9
Other assets	127.7
Long-term debt	(196.6)
	1,797.9
Financed by:	
Cash	1,088.4
Share capital	709.5
	1,797.9

During the second quarter of fiscal 1998, the Company recorded a charge of $81.7 relating to the restructuring and integration of fONOROLA along with fees and related expenses associated with the bridge financing of this acquisition. The restructuring and integration charge includes network and information technology consolidation costs of $20.0, facilities integration costs of $15.0, severance costs of $8.0 and $38.7 primarily related to the fees and related expenses associated

with the bridge financing of this acquisition and eliminating other redundancies. As at December 31, 1998, the balance of the restructuring provision included in accounts payable and accrued liabilities is $32.7, which relates primarily to network consolidation and facilities integration. The restructuring and integration is expected to be completed in 1999.

Subsequent to the acquisition, the Company repaid all of the fONOROLA long-term debt.

3. CAPITAL ASSETS

	1998			1997		
	Cost	**Accumulated Depreciation**	**Net Book Value**	Cost	Accumulated Depreciation	Net Book Value
Multiplex and telephone switch equipment	**375.0**	**81.9**	**293.1**	149.8	31.8	118.0
Fiber optic cable and equipment	**520.1**	**28.1**	**492.0**	50.0	6.4	43.6
Computer equipment and software	**149.7**	**54.4**	**95.3**	65.0	29.4	35.6
Leasehold improvements	**30.1**	**15.8**	**14.3**	14.4	6.6	7.8
Furniture and fixtures	**29.3**	**13.4**	**15.9**	17.8	9.1	8.7
Buildings	**21.1**	**1.2**	**19.9**	14.5	0.3	14.2
Land	**22.6**	**—**	**22.6**	14.7	—	14.7
	1,147.9	**194.8**	**953.1**	326.2	83.6	242.6

Included in the cost of fiber optic cable and equipment and buildings, in 1998, are construction in progress expenditures of $400.0, substantially all of which relates to the fiber network project. Construction of the fiber optic network and related assets is accounted for using percentage of completion accounting by which the capital asset and accrued liability is recognized based on the relationship of the percentage of work completed (based on engineering estimates) applied against the total expected cost of the project. Acquisitions of capital assets and changes in accounts payable and accrued liabilities as shown in the consolidated statements of cash flow have been reduced by the amount accrued as at year end.

4. OTHER ASSETS

	1998			1997		
	Cost	**Accumulated Amortization**	**Net Book Value**	Cost	Accumulated Amortization	Net Book Value
Goodwill	**1,332.3**	**39.9**	**1,292.4**	29.5	5.4	24.1
Customer lists	**138.6**	**23.8**	**114.8**	28.5	11.0	17.5
Technology and product rights	**50.8**	**28.4**	**22.4**	50.8	24.0	26.8
Financing costs	**47.7**	**7.4**	**40.3**	16.8	2.5	14.3
Other intangible assets	**4.0**	**2.6**	**1.4**	3.3	2.5	0.8
Investment in Microcell Telecommunications Inc.	**18.1**	**—**	**18.1**	18.1	—	18.1
Trademarks	**14.9**	**7.5**	**7.4**	14.9	5.9	9.0
	1,606.4	**109.6**	**1,496.8**	161.9	51.3	110.6

5. OPERATING LINE OF CREDIT

At December 31, 1998, the Company had a credit facility from a syndicate of banks in the amount of $75.0. Amounts advanced under the credit facility are payable on demand and bear interest, at the Company's option, at a rate per annum based on either the banks' prime rate or the Bankers' Acceptance rate. Borrowings under the credit facility are collateralized by charges over accounts receivable. The amount available under this line is reduced by unfavorable swap agreements. At December 31, 1998, the Company could have drawn $16.1 under this credit facility [1997 – $54.7].

6. LONG-TERM DEBT

	Interest Rate	1998	1997
(a) Senior Discount Notes due 2004	13.25%	**255.0**	213.7
(b) Senior Discount Notes due 2007	9.27%	**274.0**	251.2
(b) Senior Notes due 2007	8.375%	**100.0**	100.0
(c) Senior Discount Notes due 2008	8.94%	**441.4**	—
(c) Senior Notes due 2008	8.00%	**262.3**	—
		1,332.7	564.9

(a) Senior Discount Notes due 2004

The Company's U.S. $190.1 Senior Discount Notes ["the 2004 Discount Notes"] mature on December 1, 2004. The 2004 Discount Notes were issued in 1994 at a 47.405% discount to their principal amount, reflecting that no cash interest will be payable prior to December 1, 1999. Thereafter, cash interest will accrue at 13.25% per annum payable semi-annually on each of June 1 and December 1. The 2004 Discount Notes are redeemable in whole or in part at the option of the Company any time after December 1, 1999 at 106.625% of the principal amount, declining ratably to 100% of the principal amount on or after December 1, 2002 plus, in each case, interest accrued to the date of redemption.

(b) Senior Discount Notes and Senior Notes due 2007

The Company's U.S. $275.0 Senior Discount Notes ["the 2007 Discount Notes"] mature on August 15, 2007. The 2007 Discount Notes were issued in 1997 at a 36.321% discount to their principal amount, reflecting that no cash interest will be payable prior to August 15, 2002. Thereafter, cash interest will accrue at 9.27% per annum payable semi-annually on each of August 15 and February 15. The 2007 Discount Notes are redeemable in whole or in part at the option of the Company any time after August 15, 2002 at 104.635% of the principal amount, declining ratably to 100% of the principal amount on or after August 15, 2004 plus, in each case, interest accrued to the date of redemption.

The Company's $100.0 Senior Notes ["the 2007 Notes"] mature on August 15, 2007. The 2007 Notes were issued in 1997 at par value. Interest is payable semi-annually on August 15 and February 15. The 2007 Notes are redeemable in whole or in part at the option of the Company any time after August 15, 2002 at 104.188% of the principal amount, declining ratably to 100% of

the principal amount on or after August 15, 2004 plus, in each case, interest accrued to the date of redemption.

(c) Senior Discount Notes and Senior Notes due 2008

The Company's U.S. $436.0 Senior Discount Notes ["the 2008 Discount Notes"] mature on August 15, 2008. The 2008 Discount Notes were issued in 1998 at a 35.751% discount to their principal amount, reflecting that no cash interest will be payable prior to August 15, 2003. Thereafter, cash interest will accrue at 8.94% per annum payable semi-annually on each of August 15 and February 15. The 2008 Discount Notes are redeemable in whole or in part at the option of the Company any time after August 15, 2003 at 104.47% of the principal amount, declining ratably to 100% of the principal amount on or after August 15, 2006 plus, in each case, interest accrued to the date of redemption.

The Company's U.S. $175.0 Senior Notes ["the 2008 Notes"] mature on August 15, 2008. The 2008 Notes were issued in 1998 at approximately par value. Interest is payable semi-annually on August 15 and February 15. The 2008 Notes are redeemable in whole or in part at the option of the Company any time after August 15, 2003 at 104.0% of the principal amount, declining ratably to 100% of the principal amount on or after August 15, 2006, plus, in each case, interest accrued to the date of redemption.

Each of the Company's senior notes and senior discount notes are unsecured obligations and rank *pari passu* in right of payment with all unsubordinated, unsecured indebtedness of the Company. The senior discount notes and the senior notes are governed by trust indentures which contain certain covenants which, among other things, restrict the ability of the Company to incur additional indebtedness, incur liens, pay dividends or repurchase the Company's capital stock.

(d) Hedging Activities

The Company has entered into cross-currency interest rate swap agreements to reduce the Company's exposure to additional changes in the exchange rate of the U.S. dollar as compared to the Canadian dollar. The effect of these agreements is to convert the 2004 Discount Notes into a 14.45% Canadian dollar obligation, the 2007 Discount Notes into an 8.91% Canadian dollar obligation, the 2008 Notes into a 7.80% Canadian dollar obligation and the hedged portion of the 2008 Discount Notes into a 8.67% Canadian dollar obligation, in all cases calculated on a semi-annual bond equivalent basis.

The Company's obligations under the cross-currency interest rate swap agreements are collateralized by charges over accounts receivable.

(e) Lucent Technologies Inc. Financing Agreement

The Company has entered into a five-year agreement with Lucent Technologies Inc. ["Lucent"] for the purchase of up to $400.0 of Lucent equipment for the build-out of its local services network. Lucent will provide financing of up to $400.0 related to the Company's entry into the local services market in Canada.

The credit facility consists of three tranches of $150.0, $150.0 and $100.0 all of which have an 8.5 year term to maturity. The first tranche has a two-year availability period while tranches two and three have a three-year availability period. For all three tranches, principal repayments

commence in year four. Of the principal, 78% is required to be repaid in the last 18 months. The credit facility bears interest at a rate per annum based on the Bankers' Acceptance rate plus a percentage that varies depending upon the Company's ratio of debt to cash flow. The credit facility is collateralized by equipment purchased from Lucent and contains certain covenants which, among other things, require the company to maintain certain financial covenants and restrict the ability of the Company to incur additional indebtedness, incur liens, pay dividends or repurchase the Company's capital stock. As at December 31, 1998 no amounts were available to be drawn under this facility.

7. CAPITAL STOCK

Certain restrictions on the payment of dividends exist as a result of the long-term debt issued in 1994, 1997 and 1998 and the financing agreement with Lucent [note 6].

Common Shares

The Company is authorized to issue an unlimited number of Common Shares. The holders of Common Shares are entitled to one vote for each share held at any meeting of shareholders of the Company. The Common Shares may be subject to constraints on transfer to ensure the Company's compliance with the foreign ownership provisions of the Telecommunications Act (Canada).

Preferred Shares

The Company is authorized to issue in series an unlimited number of Preferred Shares of which none were outstanding at December 31, 1998, 1997 and 1996. The Board will determine the rights and attributes when each series is issued.

Class B Non-Voting Shares

The Class B Non-Voting Shares were created in October 1993 when each Common Share then outstanding was converted into one Common Share and one Class B Non-Voting Share.

The Class B Non-Voting Shares rank *pari passu* with Common Shares and Class C Non-Voting Shares on a per share basis with respect to the payment of dividends and the right to participate in a distribution of assets of the Company on winding up, dissolution or otherwise. The holders of Class B Non-Voting Shares are not entitled to vote at any meeting of shareholders of the Company.

Class C Non-Voting Shares

The Class C Non-Voting Shares may not be held by parties other than Sprint Communications Company L.P. ["Sprint U.S."], its affiliates and permitted associates. The Class C Non-Voting Shares rank *pari passu* with Common Shares and Class B Non-Voting Shares on a per share basis with respect to the payment of dividends and the right to participate in a distribution of assets of the Company on winding up, dissolution or otherwise. The holders of Class C Non-Voting Shares are not entitled to vote at any meeting of shareholders of the Company. However, the holders of the Class C Non-Voting Shares are entitled to elect up to three directors of the Company as long as they maintain a significant equity interest in the Company.

Number of Shares	Common	Class B	Class C
Balance, December 31, 1995	**16,903,346**	**20,567,784**	**12,132,073**
Issued pursuant to options	472,800	1,050,691	—
Balance, December 31, 1996	**17,376,146**	**21,618,475**	**12,132,073**
Issued pursuant to options	203,100	888,925	—
Issued to Sprint U.S	—	—	866,134
Balance, December 31, 1997	**17,579,246**	**22,507,400**	**12,998,207**
Issued pursuant to options	1,150	189,767	—
Issued pursuant to fONOROLA acquisition	—	28,214,437	—
Issued to Sprint U.S.	—	—	8,776,810
Balance, December 31, 1998	**17,580,396**	**50,911,604**	**21,775,017**

Dollars	Common	Class B	Class C
Balance, December 31, 1995	**119.9**	**135.2**	**117.5**
Issued pursuant to options	2.9	7.7	—
Balance, December 31, 1996	**122.8**	**142.9**	**117.5**
Issued pursuant to options	2.0	8.4	—
Issued to Sprint U.S.	—	—	10.9
Balance, December 31, 1997	**124.8**	**151.3**	**128.4**
Issued pursuant to options	—	1.6	—
Issued pursuant to fONOROLA acquisition	—	709.5	—
Issued to Sprint U.S.	—	—	219.4
Balance, December 31, 1998	**124.8**	**862.4**	**347.8**

1998 Transactions

Pursuant to the acquisition of fONOROLA, on June 29, 1998 and on July 30, 1998, the Company issued an aggregate of 28,214,437 Class B Shares having a value of $709.5. All of the Class C Shares were purchased by Sprint U.S. pursuant to its option to maintain its approximate 25% equity interest in the Company.

1997 Transactions

On August 25, 1997, all of the Class C Shares issued were purchased by Sprint U.S. pursuant to agreements which give Sprint U.S. the option to maintain a 25% equity interest in the Company. The agreements have an initial term of 10 years, beginning August 4, 1993, subject to automatic five-year renewal periods if neither party elects to terminate the arrangement.

Stock Options

The outstanding stock options have expiry dates ranging from 1999 to 2005 with exercise prices ranging from $5.00 to $27.60. The following is a continuity of stock options outstanding for which shares have been reserved:

	1998		1997	
	Common	**Class B**	Common	Class B
Balance, beginning of year	**836,559**	**2,533,187**	889,659	2,689,897
Granted during the year	**210,000**	**502,425**	150,000	780,000
Cancelled during the year	**(50,000)**	**(186,601)**	—	(47,785)
Exercised during the year	**(1,150)**	**(189,767)**	(203,100)	(888,925)
Balance, end of year	**995,409**	**2,659,244**	836,559	2,533,187
Weighted average exercise price per share on outstanding options at end of year	**$16.67**	**$15.71**	$15.09	$14.57

All options of the Company are granted pursuant to a Director and Employee Stock Option Plan [the "Plan"] from shares reserved for issuance upon the exercise of options granted under such Plan. At the Company's Annual General Meeting held on May 13, 1998, the shareholders increased the maximum number of shares reserved for issuance upon the exercise of options granted under the Plan by 750,000 Common Shares and 2,500,000 Class B Non-Voting Shares. The number of shares reserved and available for issuance upon the exercise of future options granted is summarized below:

	1998		1997	
	Common	**Class B**	Common	Class B
Balance, beginning of year	**377,874**	**349,544**	527,874	1,081,759
Options granted during the year	**(210,000)**	**(502,425)**	(150,000)	(780,000)
Increase in number of shares reserved	**750,000**	**2,500,000**	—	—
Options cancelled during the year	**50,000**	**186,601**	—	47,785
Balance, end of year	**967,874**	**2,533,720**	377,874	349,544

Accordingly, the total number of Common Shares reserved for issuance pursuant to exercise of options was 1,963,283 and the total number of Class B Non-Voting Shares reserved for issuance pursuant to exercise of options was 5,192,964.

8. INCOME TAXES

Income tax provision represents Federal capital tax. At December 31, 1998, the Company had approximately $239.7 [1997 – $109.6] in losses available for Canadian income tax purposes to reduce future years' income for income tax purposes, the tax effect of which has not been recorded in the accounts. Income tax losses will expire as follows:

	1998	1997
2001	**38.2**	39.3
2002	**59.3**	60.5
2003	**9.1**	9.1
2004	**2.7**	4.6
2005	**122.4**	—
	231.7	113.5
Plus depreciation and other expenditures claimed for accounting purposes in excess of amounts recorded for income tax purposes	**8.0**	(3.9)
	239.7	109.6

Also at December 31, 1998, the Company's U.S. subsidiaries had approximately U.S. $12.7 [1997 – nil] available in losses for U.S. Federal income tax purposes to reduce future years' income for income tax purposes. The benefits resulting therefrom have not been recorded in the accounts. In 1993 and 1997, a previous parent company of the U.S. subsidiaries issued shares which resulted in a change of control for U.S. tax purposes of the U.S. subsidiaries. In 1998, the Company acquired its ownership interest in the subsidiaries. Pursuant to Section 382 of the Internal Revenue Code 1986, as amended, the Company's U.S. subsidiaries' net operating losses which were incurred prior to and including the date of these ownership changes will be restricted in terms of their deductibility for subsequent taxation years. These losses in the aggregate amount of $12.7 will expire over an eight-year period beginning in 2006 in varying amounts with U.S. $7.4 expiring in 2013.

9. FINANCIAL COMMITMENTS

The Company leases office space under operating leases that expire through 2006. The Company also has agreements with certain telephone companies that guarantee the long-term supply of network facilities at discounts to full rates.

The minimum payments under these agreements in aggregate and for each of the next five years and thereafter are as follows:

	Operating Leases	Long Distance Facilities
1999	13.1	108.6
2000	12.6	100.1
2001	11.2	82.4
2002	9.5	67.3
2003	9.0	67.5
Thereafter	26.0	3.6
	81.4	429.5

At December 31, 1998, the Company has contracted to sell a portion of its fiber optic cable. These sales were at the book value of the asset at the date of sale, which approximated market value.

10. CONTINGENCIES

Switched Hubbing

The Company and other alternative carriers currently engage in the practice of switched hubbing certain of their international traffic. In May 1997, the Canadian Radio-television and Telecommunications Commission [the "CRTC"] ruled on a proceeding begun in August 1996 that such a practice was not in accordance with Canadian law and authorized Teleglobe Inc. ["Teleglobe"] to bill the Company for amounts it would otherwise have received had the Company not switch-hubbed certain of its traffic, less appropriate offsets. In December 1997, the CRTC varied its initial decision and ruled that the practice of switched hubbing was permissible from May 5, 1997 onward, but reaffirmed its decision that the Company was not permitted to engage in switched

hubbing from August 13, 1996 to May 5, 1997. The CRTC ordered the Company to provide details of its international traffic during this period which was not routed to Teleglobe. It will then conduct a proceeding to determine how much compensation [net of appropriate offsets], if any, that the Company should pay to Teleglobe. Management believes that any future decision by the CRTC which requires the Company to compensate Teleglobe, which is upheld by the courts, or election by Teleglobe to seek compensation from the Company, could have a material adverse effect on the Company's operations and financial condition.

Litigation

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to estimate the potential costs and losses, if any, management believes that the ultimate resolution of such contingencies will not have a material adverse effect on the consolidated financial position of the Company.

Year 2000

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect the Company's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Company, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

11. RELATED PARTY TRANSACTIONS

The Company has engaged in significant sales and purchases of goods and services with related parties for each of the three years ended December 31, 1998 in the normal course of operations under normal trade terms and conditions. At December 31, 1998, the net balance due to these parties is $3.9 [1997 – $32.5].

12. EARNINGS (LOSS) PER SHARE

Earnings (loss) per share have been calculated on the basis of income (loss) less preferred share dividends, divided by the weighted average number of Common Shares, Class B Shares and Class C Shares outstanding during the year [note 7] [1998 – 71,309,030; 1997 – 51,841,565 and 1996 – 50,622,652]. The potential exercise of stock options has no current dilutive effect on earnings (loss) per share.

13. ADDITIONAL FINANCIAL INFORMATION

(a) Fair Values

The carrying amounts and estimated fair values of the Company's financial instruments as of December 31, 1998 and 1997 are as follows:

	1998		1997	
	Carrying Amount	**Estimated Fair Value**	Carrying Amount	Estimated Fair Value
Financial assets				
Cash and short-term investments	**189.3**	**189.3**	558.4	558.4
Accounts receivable	**235.1**	**235.1**	141.9	141.9
Investment in Microcell [note 4]	**18.1**	**54.0**	18.1	56.9
Financial liabilities				
Bank indebtedness	**41.8**	**41.8**	—	—
Accounts payable and accrued liabilities	**515.4**	**515.4**	198.0	198.0
Long-term debt	**1,332.7**	**1,266.4**	564.9	618.0
Off-balance sheet instruments				
Favorable (unfavorable) currency and interest rate agreements	—	**54.2**	—	(6.8)

The fair values of the Company's financial instruments have been determined as outlined below, however, the estimated fair values do not necessarily represent amounts that the Company could potentially realize or be obligated to pay in a current market exchange between arm's length parties:

Cash and short-term investments and accounts receivable

The carrying values of the Company's cash and short-term investments and accounts receivable approximate fair value due to their current nature.

Investment in Microcell Telecommunications, Inc.

The fair value of the Company's investment in Microcell is based on the closing price on The Toronto Stock Exchange.

Bank indebtedness, accounts payable and accrued liabilities

The carrying values of the Company's bank indebtedness, accounts payable and accrued liabilities approximates fair value due to their current nature.

Long-term debt

The fair value of the Company's long-term debt is estimated based on current trading values.

Currency and interest rate agreements

The fair values of the cross-currency interest rate swap agreements and the interest rate swaps are based on values quoted by the counterparties to the agreements.

Foreign currency contracts

The fair value of foreign currency contracts is estimated as the replacement cost of the contracts at December 31, 1998 and 1997, taking into account the current foreign currency exchange rates.

(b) Other Disclosures

Credit Risk

Short-term investments are placed exclusively with entities with entities ratings of at least R-1 (mid) by a recognized Canadian debt rating agency.

The Company's accounts receivable are not subject to any concentration of credit risk. The portfolio is diversified as to both geographic and industry concentrations.

Cross-currency interest rate swap agreements, interest rate swap agreements and foreign currency contracts involve the risk of dealing with counterparties and their ability to meet the terms of the contracts. In the event of non-performance by the counterparties, the Company's accounting loss would be limited to the net amount that it would be entitled to receive under the terms of the applicable cross-currency interest rate swap agreement, interest rate swap agreement or foreign currency contract. However, the Company has a policy of only dealing with large, creditworthy financial institutions and therefore does not anticipate non-performance by any of the counterparties with which it has such agreements.

Currency and Interest Rate Agreements

The Company has entered into cross-currency interest rate swap agreements to hedge its exposure to adverse movements in the relationship between the Canadian and U.S. dollars created under the Company's debt obligations. Of the U.S. $1,664.4 that will be paid in principal and interest over the term of these instruments, the Company has hedged approximately 75.8% of the exposure. Also, the Company uses interest rate swap agreements to hedge its exposure to adverse interest rate movements. At December 31, 1998, the Company had entered into interest rate swap agreements expiring December 1, 2004 with a notional amount outstanding of U.S. $202.7 [1997 – $202.7].

Foreign Currency Contracts

From time to time, the Company purchases over-the-counter forward exchange contracts to hedge the purchase of U.S. dollars needed to settle U.S. dollar denominated trade obligations. At December 31, 1998 and 1997, the Company had no outstanding balances under these contracts.

14. SEGMENTED INFORMATION

The Company is a facilities-based carrier of long distance voice and data telecommunications services comprising a single business segment. Substantially all of the Company's assets are located in Canada, and revenues are derived from long distance voice and data telecommunications services provided in Canada.

15. RECONCILIATION TO ACCOUNTING PRINCIPLES GENERALLY ACCEPTED IN THE UNITED STATES

These consolidated financial statements have been prepared in accordance with Canadian GAAP, which differ in certain respects from U.S GAAP. The significant adjustments which are described below would be required in the consolidated financial statements to comply with U.S. GAAP.

Balance Sheets – Assets and Liabilities

	1998	1997	1996
Canadian GAAP			
Cash and short-term investments	**189.3**	558.4	170.1
Capital assets	**953.1**	242.6	169.7
Other assets	**1,496.8**	110.6	116.0
United States GAAP			
Cash and cash equivalents	**71.2**	393.7	110.4
Short-term investments available for sale	**118.1**	164.7	59.7
Capital assets	**1,069.5**	242.6	169.7
Other investment available for sale	**54.0**	56.9	—
Other assets	**1,582.8**	92.5	116.0
Future tax liability	**(213.8)**	(17.1)	—

U.S. GAAP classifies cash and cash equivalents to exclude short-term investments which mature more than three months from the date of their acquisition.

Under Canadian GAAP, portfolio investments are accounted for at the lower of cost and market. Under U.S. GAAP, portfolio investments classified as available for sale are carried at market values with unrealized gains or losses reflected as a component of other comprehensive income. SFAS 115

Under U.S. GAAP, Statement of Financial Accounting Standard No.109 requires an asset and liability approach to financial accounting for income taxes. The application of this method also gives rise to differences in the allocation of consideration with respect to business combinations which results in the recognition of a future tax liability and an offsetting charge to capital and other assets. As at December 31, 1998, future tax asset net of a valuation allowance is nil [1997 and 1996 – nil]. SFAS 109

Under U.S. GAAP, interest expense of $8.4 [1997 and 1996 – nil] would have been capitalized as part of the cost of constructing fiber optic cable and buildings. Under Canadian GAAP these amounts have been expensed. interest cap

32.

Under U.S. GAAP, purchase accounting requires certain integration costs arising from an acquisition to be capitalized as part of the purchase equation and would increase goodwill. Under Canadian GAAP, these integration costs were expensed.

Balance Sheets – Shareholders' Equity

	1998	1997	1996
Capital Stock			
Canadian GAAP	1,335.0	404.5	383.2
Share purchase incentives	4.6	4.6	4.6
Reduction in stated capital	10.7	10.7	10.7
U.S. GAAP – Capital Stock	1,350.3	419.8	398.5
Deficit			
Canadian GAAP	(350.6)	(113.9)	(130.2)
Share purchase incentives	(4.6)	(4.6)	(4.6)
Reduction in stated capital	(10.7)	(10.7)	(10.7)
Integration costs capitalized	26.3	—	—
Deferred foreign exchange losses	(12.2)	—	—
Capitalized interest	8.4	—	—
U.S. GAAP – Deficit	(343.4)	(129.2)	(145.5)
Other Comprehensive Income			
Canadian GAAP	—	—	—
Unrealized gains on investment available for sale	20.1	21.7	—
U.S. GAAP – Other Comprehensive Income	20.1	21.7	—

intra-capital differences

32. ii. 64.

Under Canadian GAAP, stock options are accounted for at the date of exercise when the purchase is recorded as an increase to capital stock. For purposes of reconciliation to U.S. GAAP, stock options granted to employees have been accounted for in accordance to APB 25, such that the excess of the market value of the shares over the exercise price is expensed and charged to income with a corresponding increase to capital stock over the vesting period.

Canadian GAAP allows for the reduction of the stated capital of outstanding shares with a corresponding offset to deficit. This reclassification which the Company made in 1992 is not permitted by U.S. GAAP.

Fx

Under U.S. GAAP, foreign exchange gains or losses from the translation of long-term monetary items are included in income as incurred. Under Canadian GAAP, foreign exchange gains or losses on the translation of long-term monetary items are deferred and amortized.

For purposes of reconciliation to U.S. GAAP, the Company presents the new disclosure requirements of Financial Accounting Standard No. 130 ["SFAS 130"] in these consolidated financial statements. SFAS 130 requires the presentation of comprehensive income and its components. Comprehensive income includes all changes in equity during a period except shareholder transactions.

see I/S

Statements of Operations

	1998	1997	1996
Net income (loss) based on Canadian GAAP	(236.7) ✓	16.3	(7.1)
Integration costs capitalized 32.	26.3	—	—
Deferred foreign exchange losses item i — FX	(12.2)	—	—
Capitalized interest 64.	8.4	—	—
Net income (loss) based on U.S. GAAP	(214.2)	16.3	(7.1)
Unrealized gains (losses) on other assets available for sale	(1.6)	21.7	—
Comprehensive income (loss) based on U.S. GAAP	(215.8)	38.0	(7.1)

U.S. GAAP does not recognize the disclosure of a subtotal of the amount of earnings before interest, taxes and depreciation and amortization in the consolidated statements of operations and deficit.

Earnings (Loss) Per Share

	1998	1997	1996
Net income (loss) – basic and diluted	(3.00)	0.31	(0.14)

Statements of Cash Flows

	1998	1997	1996
Cash provided by (used in) operating activities	(74.1)	138.7	50.6
Cash used in investing activities	(799.0)	(209.4)	(24.6)
Cash provided by financing activities	550.6	354.0	7.1
Net increase (decrease) in cash	(322.5)	283.3	33.1
Cash and cash equivalents, beginning of year	393.7	110.4	77.3
Cash and cash equivalents, end of year	71.2	393.7	110.4

U.S. GAAP does not recognize the disclosure of a subtotal of the amount of funds provided by operations before changes in non-cash working capital items in the statements of cash flows.

U.S. GAAP excludes non-cash transactions from the statements of cash flows, including acquisitions for share consideration and the conversion of liabilities to equity.

Historical Review	1998	1997	1996	1995	1994	1993
Statement of Operations ($MM)						
Revenue	**1,227.6**	920.9	712.6	457.5	176.3	133.9
Gross Margin	**35.8%**	45.1%	37.6%	34.0%	29.0%	33.7%
EBITDA	**(22.0)**	90.5	43.1	(15.7)	(31.1)	8.8
Net Income (loss)	**(236.7)**	16.3	(7.1)	(64.7)	(55.4)	(3.1)
Earnings (loss) Per Share	**(3.32)**	0.31	(0.14)	(1.58)	(1.62)	(0.16)
Balance Sheet ($MM)						
Working Capital	**(132.8)**	502.3	155.6	165.1	144.4	94.0
Total Assets	**2,874.3**	1,053.5	575.5	524.8	400.0	254.8
Long-term Debt	**1,332.7**	564.9	186.0	168.1	140.9	10.8
Shareholders' Equity	**984.4**	290.6	253.0	249.5	204.3	222.9

1998 Quarterly Review	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
(Unaudited)	**1998**	1997	**1998**	1997	**1998**	1997	**1998**	1997
Statement of Operations ($MM)								
Revenue	**258.1**	207.7	**258.5**	224.5	**358.8**	236.6	**352.2**	252.2
Gross Margin	**42.1%**	43.3%	**42.1%**	44.0%	**31.2%**	46.3%	**31.4%**	46.4%
EBITDA	**23.2**	20.2	**(59.0)**	25.7	**10.9**	24.0	**2.9**	20.6
Net Income (loss)	**3.2**	4.6	**(84.7)**	9.5	**(76.1)**	4.9	**(79.1)**	(2.8)
Earnings (loss) Per Share	**0.06**	0.09	**(1.57)**	0.18	**(0.91)**	0.09	**(0.90)**	(0.05)
Balance Sheet ($MM)								
Working Capital	**507.5**	168.4	**69.3**	178.2	**121.9**	541.1	**(132.8)**	502.3
Total Assets	**1,048.6**	615.2	**2,829.6**	619.6	**2,755.1**	1,014.5	**2,874.3**	1,053.5
Long-term Debt	**577.5**	192.5	**1,349.5**	199.3	**1,304.3**	553.0	**1,332.7**	564.9
Shareholders' Equity	**294.3**	259.2	**884.4**	269.4	**1,063.6**	289.8	**984.4**	290.6

Stock Information	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	Common	Class B	Common	Class B	Common	Class B	Common	Class B
1998 share price ($) and trading volume								
High	**28.00**	**28.00**	**28.75**	**28.75**	**28.35**	**28.00**	**15.50**	**15.00**
Low	**17.50**	**18.00**	**21.50**	**21.85**	**10.00**	**9.85**	**9.25**	**9.25**
Close	**25.50**	**25.50**	**26.00**	**25.00**	**10.50**	**10.50**	**14.00**	**13.75**
Volume (000s)	**5,998**	**6,103**	**4,414**	**14,779**	**5,284**	**23,037**	**3,674**	**17,721**
1997 share price ($) and trading volume								
High	21.50	22.00	24.25	23.00	28.75	28.75	29.75	29.75
Low	17.50	16.25	18.75	18.50	23.25	22.50	20.50	20.80
Close	21.50	22.00	23.25	22.50	27.35	27.25	22.45	22.45
Volume (000s)	2,215	2,796	2,926	6,078	2,475	3,509	3,011	2,527

CORPORATE DIRECTORY

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* Member of Audit Committee
◆ Member of Compensation and Human Resources Committee
▲ Member of Corporate Governance and Nominating Committee

SHAREHOLDER INFORMATION

CALL-NET ENTERPRISES INC.

Head Office
2235 Sheppard Avenue East
Atria II, Suite 1800
Toronto, Ontario
M2J 5G1

Transfer Agent and Registrar
Call-Net's transfer agent and registrar is CIBC Mellon Trust Company, Toronto, Montreal and Vancouver. Changes of address or inquiries about shares and dividends should be directed to the transfer agent.

Stock Exchange Listings
The Common Shares of Call-Net Enterprises Inc. are listed on the Montreal and Toronto stock exchanges under the stock symbol CN. The Class B Non-Voting Shares of Call-Net are listed on the Montreal and Toronto stock exchanges under the symbol CN.B, and on The Nasdaq Stock Market under the symbol CNEBF.

Annual Meeting
The annual meeting of shareholders will be held at 11:00 a.m. on Wednesday, May 19, 1999, at The Royal York Hotel in Toronto, Ontario.

Shareholder Inquiries
Shareholder inquiries should be directed to: Office of the Senior Vice President and Chief Financial Officer, at (416) 718-6408.

Ownership and Voting Rights of Call-Net Enterprises Inc.
Call-Net Enterprises Inc. is a Canadian company widely held by public shareholders. Through its wholly owned subsidiaries, Sprint Canada Inc., Call-Net Communications Inc., AlternaCall Inc. and Call-Net Technology Services Inc., the Company offers local, long distance and data telecommunications services to the public. As of February 28, 1999, the Company's shareholders' equity consisted of issued and outstanding Common Shares, Class B Non-Voting Shares and Class C Non-Voting Shares.

To ensure that the Company or its affiliates remain qualified to operate as a telecommunications common carrier pursuant to the Telecommunications Act (Canada), and the regulations made thereunder ("Telecommunictions Legislation"), the Articles of the Company impose certain restrictions on the issue and transfer of Common Shares of the Company to non-Canadians, as defined in the Telecommunications Legislation. The Board of Directors of the Company may establish, amend or repeal any procedure required to administer such restrictions on the issuance and transfer of the Common Shares of the Company.

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